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STATE DOCUMENTS

STATE OF MONTANA
OFFICE OF THE STATE TREASURER
REPORT ON EXAMINATION
Calendar Year Ended December 31, 1969

MONTANA STATE - 1968
930 East Lincoln Avenue
Helena, Montana 59601



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MONTANA
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STATE OF MONTANA
OFFICE OF THE STATE TREASURER
REPORT ON EXAMINATION
Calendar Year Ended December 31, 1969

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ELECTIVE AND ADMINISTRATIVE OFFICIALS

OFFICE OF THE STATE TREASURER

Hon. Alex B. Stephenson

State Treasurer

Mrs. Fern L. Baker

Deputy State Treasurer

SUMMARY OF RECOMMENDATIONS

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Establish a general ledger and double entry system.	7
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STATE OF MONTANA
Office of the Legislative Auditor
STATE CAPITOL
HELENA, MONTANA 59601

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the combined funds balance sheet of the Office of the State Treasurer as of December 31, 1969, and the related statements of operations as set forth in the table of contents in this report, for the calendar year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The financial statements have been prepared on the cash basis of accounting and do not show financial position or operating results as do statements prepared on the modified accrual basis in accordance with generally accepted accounting principles applicable to governmental units.

The Treasurer's Office does not maintain a general ledger nor does it utilize the double entry system of accounting. Accordingly, the financial statements have been prepared based upon detail records maintained by that office.

Unrecorded and not reported in the accompanying financial statements are investments of approximately \$65,500,000, the nature of which is discussed in

the comments section of the report. Also not recorded in the financial statements are accounts receivable resulting from the office's abandoned property operations and fixed assets, both of which are of undeterminable amounts, but which are estimated to be materially significant as outlined in the comments section of this report.

Because of the materiality of the exceptions described in the preceding paragraph and in the comments section of this report, we are of the opinion that the accompanying balance sheet does not present fairly the financial position of the State Treasury at December 31, 1969, and the statement of changes in fund accountability does not present fairly the changes in fund accountability for the calendar year then ended.

In our opinion, subject to the exceptions described in the preceding paragraphs, the accompanying statement of expenditures and encumbrances compared with appropriations presents fairly the results of the Office of the State Treasurer's operations for the calendar year ended December 31, 1969, in conformity with generally accepted governmental accounting principles applied on a basis consistent with that of the preceding year.

We submit the financial statements listed in the preceding table of contents together with the following comments.

COMMENTS

GENERAL

The Office of the State Treasurer is a constitutional office filled by a direct election of the people every four years. The position is unique in that the State Treasurer is the only state officer prohibited by the Constitution from succeeding himself in office. The Constitution also prescribes the minimum qualifications for the office, i.e., at least 25 years of age; a citizen of the United States; and a resident of Montana for two years or more. Neither the Constitution nor the statutes require that the incumbent of the office have any degree of financial or administrative expertise or experience, or that the holder have a minimum level of education. As a result, election to the office of state treasurer is entirely dependent upon the general public's view of a candidate's qualifications. Because of this, state treasurers have come from a wide range of backgrounds, including businessmen, attorneys, chiropractor, former state auditor, and the spouse of a deceased state treasurer. The present state treasurer was formerly the chief of the Montana Highway Patrol.

Various sections of the Constitution and statutes charge the State Treasurer's Office (hereafter referred to as treasurer) with the custodianship of state moneys. Section 79-306, R.C.M. 1947, specifically designates the state treasurer as the treasurer of all state boards, commissions, bureaus, departments and institutions, while Section 79-201 prescribes the general duties of the treasurer. These duties include, but are not limited to, the receipt and custody of all state moneys; payment and redemption of warrants; redemption of bonds and coupons; and the keeping of accounts to reflect the moneys in the various funds.

The treasury fund structure consists of nine basic treasury funds through which the financial transactions of most state agencies flow, and from which most are financed. These funds were established by the Treasury Fund Structure Act of 1963 (Chapter 147, Laws of 1963) and consist of independent fiscal and accounting classifications which segregate state money in accordance with various principles, regulations, and constitutional and statutory restrictions. The treasurer's principal function is to account for the receipts, disbursements, and balances in these funds. In most instances the determination as to which fund to record transactions is made by the various state agencies; however, the treasurer verifies, to a limited extent, that the transactions are appropriate. For the most part, however, the treasurer functions in much the same manner for the state as a commercial bank does for a business by receiving and safeguarding money, and paying it upon demand.

ACCOUNTING SYSTEM AND FINANCIAL STATEMENTS

It is generally accepted that accounting exists for two prime reasons: (1) to provide complete and accurate financial information in proper form on a timely basis, and (2) to exercise control over an organization's functions in accordance with generally accepted principles, laws, or other restrictions. The accounting process usually entails a vast number of time-tested and generally accepted concepts, techniques, procedures, and reports which are designed and implemented to clearly show that all applicable legal provisions have been complied with and to fairly and fully disclose the financial position and results of financial operations of the governmental unit.

In the case of the treasurer, we found a noticeable absence of proper accounting and reporting procedures. The treasurer does not have a system of general

accounting and financial reporting to adequately account for and disclose its activities. The treasurer does not maintain a general ledger, the basic accounting record of any business or governmental unit, nor does it utilize the double entry system of accounts, one of the most basic accounting techniques. The records maintained by the treasurer primarily reflect only the cash balances of the various funds and accounts under its control, with invested cash being excluded from the fund balances. As a result, the total fund balances of \$77,330,000 reflected in the treasurer's records at December 31, 1969, is actually a cash balance, with the actual fund balance of cash and invested cash being over \$233,500,000, a difference of \$156,000,000 (Exhibit A). We believe this and other similar features inherent in the present system described elsewhere in this report, tend to distort the true posture of the treasury and mislead the people who use such information.

No general ledger control or double entry system of accounts are maintained for the treasurer's own operations. Expenditure and appropriation data are recorded on memorandum-type records with little resemblance of an accounting system. We believe that a properly designed accounting system utilizing double entry accounts and a general ledger to record and reflect all of the financial activities of the treasurer, would overcome many of the deficiencies which currently exist, by providing accurate and complete recording of all transactions and a basis for full disclosure in periodic financial reports.

The treasurer prepares one periodic financial report. This monthly report, which is termed the "state treasurer's trial balance," has been prepared for many years and is purported to present the financial position of the treasury each

month, but it is incomplete. Besides reflecting the understated fund balances described above, the report does not disclose the composition of cash and cash items as described later in this report. As a result, the report is not used by any of the five offices which receive it.

Although we question the accuracy of the report, we sympathize with the treasurer in that nowhere were we able to find a clear delineation of the type of reports required of the treasurer. To the contrary, we found an abundance of confusing and conflicting constitutional and statutory reporting requirements. Various sections of the Constitution and law require the treasurer to prepare financial reports of some nature. For example, Article XII, Section 13, of the Constitution as well as Section 79-806, R.C.M. 1947, require quarterly reports to the governor under oath while Section 79-705 specifies a semiannual report under oath. In contrast, Section 59-701, requires that the treasurer prepare and submit an annual report to the state controller, with no mention of oath, while Section 79-201 requires a report in compliance with statutes which have been repealed. The content and format of the required reports also vary widely. In one case, the treasurer is required to post on his door a list of all outstanding warrants (Section 79-801, R.C.M. 1947) while in another, the treasurer is supposed to prepare a "balance sheet" showing a summary of accounts and the identity of all warrants paid (Section 79-806, R.C.M. 1947).

We believe that prompt action should be taken by the state treasurer to evaluate and clarify the requirements of law, assess the present situation in view of these requirements, and establish a meaningful and accurate system of accounting for and reporting financial activities of his office.

RECOMMENDATION

We recommend that the state treasurer:

1. *Seek the assistance of the state controller in establishing a general ledger utilizing the double entry system to account for the activities of his office in accordance with generally accepted governmental accounting principles.*
2. *Consult with the Offices of the State Controller, Attorney General, and others as necessary to:*
 - (a) *determine the type and frequency of financial reports necessary to properly disclose the financial activities and position of the treasury, and*
 - (b) *ascertain the action necessary to clarify the requirements of law insofar as periodic reports are concerned, and delete these statutes which are no longer relevant.*
3. *Prepare annual and interim financial statements that accurately and fully present the financial condition of the treasury in accordance with generally accepted governmental accounting and reporting standards.*

INTERNAL CONTROLS

Internal controls comprise a plan of organization and all of the coordinate methods and measures adopted and practiced to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed policies.

Because the treasurer is constitutionally the custodian of state cash and other resources, we believe the existence of deliberate and strong internal controls

is mandatory if the treasurer is to adequately meet its statutory and constitutional responsibilities.

Absence of Written Policies and Procedures

The treasurer has no written guidance such as policies and procedures relative to the various functions performed. Techniques and methods for accomplishing day-to-day work are learned by employees with the system functioning without any formal guidelines or criteria. As a result, it is difficult to ascertain how the various processes function, to whom the duties are assigned, and who is responsible for their completion.

We believe the absence of written policies and procedures is serious from the standpoint that the treasurer is the custodian of all the state's cash and investment resources and that such written guidance is imperative since the entire treasury staff can turn over every four years.

RECOMMENDATION

We recommend that the state treasurer:

- 1. Identify and specifically assign in writing the various duties and responsibilities within the Treasurer's Office.*
- 2. Establish written policies and procedures governing the various operations, processes, and functions within the Treasurer's Office.*

Excessive Amount of Cash On Hand

We noted during the course of our examination that the cash balance on hand in the treasury was usually a significant amount. For example, during the first

quarter of calendar year 1970, the balance of cash and cash items on hand such as warrants and checks ranged from a low of \$24,000 to a high of about \$300,000. Although these balances included checks and warrants, the actual amount of currency and coin in each respective instance was \$21,000 and \$40,000. At the time of our cash count at the end of March 1970, both the state treasurer and his deputy had cash change funds of \$5,000 while the cashier had over \$6,700 in currency and coin, and an additional \$21,200 was in the treasury vault. As a result, almost \$38,000 in currency and coin was being retained on the premises of the treasurer.

The amount of cash retained by the treasurer was not formally related to tangible needs or predicted requirements. We found that the deputy treasurer's change fund was rarely used and that although the state treasurer's fund was frequently used, the amount of \$5,000 appears excessive.

We believe the amount of cash on hand should be directly commensurate with actual requirements, and that the retention of excessive amounts results in unproductive use of cash resources and subjects the state to unwarranted risk.

RECOMMENDATION

We recommend that the treasurer:

- 1. Identify and evaluate on the basis of past cash flow, the probable cash requirements at various periods during the year and adjust the various change funds accordingly.*
- 2. Reduce and retain the amount of cash on the premises at the minimum necessary to conduct business.*

Processing of Incoming Mail

Mail received by the treasurer is opened and distributed by the deputy state treasurer whose ultimate responsibility is to see that the cash and fiscal records are properly maintained. In meeting this responsibility, the deputy has complete access to and a certain degree of control over the cash and fiscal records, and also reconciles the bank accounts.

Frequently, incoming mail includes checks and other negotiable documents which the deputy identifies and distributes. The receipt of such mail is not recorded or logged in, nor is it date stamped upon receipt. As a result, there is no assurance that all mail receipts are recorded in the treasurer records, nor can one readily determine the time lag from time of receipt to time of deposit.

Basic internal control standards provide that the receiving and handling of cash and similar items be segregated from the recording and reconciling process, and that mail receipts should be recorded or logged at the point of receipt. In addition, we believe that date stamping provides a formal and convenient means of establishing the date of receipt as well as providing a means for determining that receipts and correspondence are receiving expeditious treatment.

RECOMMENDATION

We recommend that the state treasurer:

- 1. Realign the duties of receiving and opening mail to exclude employees who have access to the fiscal records.*
- 2. Initiate a process whereby all incoming mail is date stamped upon receipt and mail receipts are recorded or logged at the point of receipt.*

Theft, Robbery, and Burglary Precautions

During the course of our examination, we observed numerous matters which we believe collectively constitute serious weaknesses in the physical security of the treasurer's office. Because these matters are so numerous and their continued existence as well as common knowledge would not be in the best interest of the state, we discussed them individually with the treasurer as our examination progressed.

RECOMMENDATION

We recommend that the treasurer correct those weaknesses in physical security disclosed by our examination.

Access to the Vault

Frequently individuals who are not members of the treasurer staff are permitted to enter and leave the treasurer's vault unaccompanied. Once each month a maintenance man is allowed to enter and clean the interior of the vault, while in numerous other instances representatives of other agencies have unrestricted access to the vault during business hours.

Although the treasury staff contends that they can observe the actions of individuals in the vault from outside, we believe this to be impractical and the taking of an unwarranted risk. In fairness to the individuals in the vault and the treasury staff, we believe outsiders should not be permitted in the vault unless accompanied by a member of the treasury staff. This practice would serve to protect both the individuals involved as well as the contents of the vault.

RECOMMENDATION

We recommend that all outsiders be accompanied by treasury staff while in the vault.

Unlocked Check Protector

The check protector machine used by the treasurer was left unlocked with the key inserted during non-business hours. This machine, which is used to imprint the value on checks, has a locking device to prevent unauthorized imprinting and alteration of any checks. The treasurer should, in our opinion, use safeguard features such as this to the maximum extent. That is why the machine was purchased.

RECOMMENDATION

We recommend that the treasurer lock and remove the key from the check protector when it is not in use.

Insurance Coverage

In attempting to identify and evaluate the insurance coverage on various state property in the custody of the treasurer, we found that the treasurer does not have a summary record showing what insurance was in force and that to ascertain the existence, nature, and extent of insurance coverage, one has to physically examine the individual insurance policies. During this examination we found that there is no insurance coverage against theft, vandalism, or burglary of the treasury vault.

We believe the treasurer should have a formal record of insurance in force and that such a matter should not be relegated to memory or randomly filed insurance documents, both of which are affected by turnover of personnel, misplacement of

of records, and the possibility of fire or other loss. Such a practice poses an unwarranted risk that legitimate claims would not be filed under available policies.

We further believe that the treasurer should examine the insurance coverage, or absence of it, in view of the potential losses which could be incurred. At any given time, the treasury vault contains significant amounts of valuables, all of which are subject to robbery or burglary loss. For example, on December 31, 1969, the vault contained over \$175,000,000 in securities and over \$69,000 in cash and cash items.

RECOMMENDATION

We recommend that the treasurer:

- 1. Establish and maintain currently a written record of insurance in force.*
- 2. Consult with the state controller and Board of Examiners in evaluating the loss potential due to robbery and burglary and provide insurance coverage commensurate with the risk involved.*

Employee Surety Bonds

As was the case with respect to insurance, the treasurer does not have a written summary record showing the extent to which surety bond coverage of employees is in force. The state has a blanket surety bond which covers all state employees requiring such coverage in the performance of their duties. This blanket bond specifically excludes the state treasurer, however, and therefore a separate bond is taken out for the state treasurer.

Our examination of the surety bond ostensibly covering the state treasurer disclosed that it did not, in actuality, cover the state treasurer. The bond was issued by the bonding company in the name of the preceding state treasurer and on the face, provided no bond coverage for the present state treasurer. Our conclusions were verified by a representative of the Attorney General's Office who pointed out that the surety bond in force was an individual bond bonding a specific individual, and not a position bond bonding the incumbent state treasurer. As a result, the present state treasurer was without surety bond coverage required by law, even though the state had paid premiums of \$588.33 for such coverage since January 6, 1969.

We believe this illustrates the need for a comprehensive inventory of bond and insurance coverage which can be quickly and periodically reviewed to assure maximum protection.

RECOMMENDATION

We recommend that the treasurer:

- 1. Establish and maintain currently a written record of surety bonds in force.*
- 2. Explore the possibility of converting the state treasurer's surety bond from an individual to a position bond.*
- 3. Initiate action to obtain a refund or paid-up coverage for the \$588.33 paid for surety bond coverage which was not received.*

OPERATING EFFICIENCIES

Use of Official and Temporary Receipts

In depositing money in the treasury, various state agencies prepare temporary receipts which show the nature of the money being deposited, i.e., checks, currency, and coin, as well as the accounts to which the deposits belong. Upon receiving this temporary receipt, the treasurer date stamps the receipt, returns a copy to the depositor, verifies the money received, and prepares an official receipt which is serially numbered. Copies of the official receipt are disseminated to the depositing agency, state controller, and state auditor and are the basis for entry of the transaction in the accounting records.

The treasurer is required by Section 79-201, R.C.M. 1947, to issue a serially numbered receipt for moneys paid into the treasury and we have no question as to the necessity for the issuance of official receipts. We do question, however, the need for both temporary and official receipts. We believe the treasurer could adequately perform its function and retain sufficient control over the receipt of money through the use of a single receipt combining the features of the present official and temporary receipts. Basically the same function is performed by commercial banks which have operated with a single receipt for many years.

The treasurer could verify the amount of currency and coin upon receiving a deposit, date stamp a receipt, and return it to the depositor with the formal understanding that checks and similar items were accepted for deposit, subject to subsequent collection, in the same manner as commercial bank deposits. In the event that the deposit was later found to be in error, the treasurer could initiate a correction document to correct the accounting records. A system such as this would reduce the quantity of paperwork without an appreciable loss of control and would place the handling of errors on an exception basis.

RECOMMENDATION

We recommend that the treasurer consolidate temporary and official receipts so as to permit the issuance of only one receipt for money paid into the treasury.

Time Lag in Recording Deposits

The present method of recording and reporting of deposits in outlying banks results in an unwarranted time lag as well as needless effort. At the time of our examination, state money was being deposited by state agencies in treasurer's accounts in 136 banks around the state. The moneys deposited by these agencies are deposited to the account of the treasurer but are not recorded in the treasurer's records until a copy of the deposit slip is received from the agency. This often results in a time lag or "float" of significant amounts of money for varying periods of time. For example, on March 13, 1970, over \$165,000 had been deposited in the treasury but was not shown on the treasurer's records because of the two to four day float. Had the treasurer been immediately aware of the presence of this money, which was deposited into non-interest bearing bank accounts, it could have been invested or put to other use by the treasurer.

As a means of transferring the money from the outlying banks, the treasurer periodically draws treasurer's checks on the outlying banks in favor of the Helena banks from where investments can be readily made. Since this practice consists of the treasurer writing a check, another piece of paper is created to be accounted for and another bank account has to be reconciled each month. As a result, the treasurer has 136 bank accounts to reconcile each month. This, plus the fact that significant amounts of money are involved in the float, combines to cost the state money.

We believe the treasurer should institute procedures which will reduce the float period to the minimum time possible, such as having the banks immediately forward copies of deposit slips directly to the treasurer and require agencies making deposits in excess of a predetermined sum, immediately telephone the information to the treasurer's office.

We also believe it may be possible to alleviate the time lag and transfer funds between banks by means of the "correspondent bank process" wherein banks dealing with each other are able to transfer and offset money without the use of individual checks. The treasurer could, for example, establish an arbitrary level at which outside banks will automatically transfer funds to one of the Helena banks via the correspondent bank process, and notify the treasurer at the same time. A process such as this would relieve the treasurer of the duty of writing, accounting for, and reconciling the treasurer's checks and would, if properly designed, assist in reducing the amount of funds in the float.

RECOMMENDATION

We recommend that the treasurer institute procedures to:

- 1. Reduce the amount of time and money presently constituting the float.*
- 2. Explore the possibility of establishing a system in which funds in outlying banks are transferred without the use of treasurer's checks.*

Inadequate Bank Statements

Some of the banks around the state furnish the treasurer with skeletal bank statements which consist of summary data on deposits, withdrawals, and beginning

and ending balances. A more useful statement, which is furnished by other banks in the state, reflects the beginning and ending balances, as well as an itemization of deposits and withdrawals by amount and date. A statement of this nature provides an identification of individual items processed by the bank and facilitates the periodic reconciliations of bank accounts by the treasurer.

RECOMMENDATION

We recommend that the treasurer require all banks to furnish monthly statements which show deposits and withdrawals by amount and date.

Verification of Moneys Due the State

During the course of a year considerable sums of money are collected for the state by various counties around the state. The source of these funds includes gross vehicle weight receipts, driver license receipts, highway patrol fines, abandoned property, escheated estates, etc. Each month the various county treasurers remit the money due the state along with a report which depicts the source of the money.

There is little assurance that the state is receiving all of the money to which it is entitled, or on a timely basis. Such assurance would require periodic verification of the amounts allocated and remitted to the treasurer by the county treasurers, as well as close coordination between the treasurer, Office of the State Controller, Highway Patrol, Registrar of Motor Vehicles, and other agencies which deal with the county government.

Although the treasurer does not have the capability or statutory authority to verify the propriety of amounts due the state, the treasurer does have the responsibility, under Section 79-201, R.C.M. 1947, to collect all moneys due the

state. The treasurer has historically depended upon the Office of the State Examiner to fulfill this responsibility. Section 82-1002, R.C.M. 1947, requires the state examiner to examine the books and records of the county treasurers and other county offices. However, there has not been a coordinated effort in the past between the treasurer and the state examiner to insure that all moneys due the state are properly remitted by the counties.

RECOMMENDATION

We recommend that the treasurer and state examiner coordinate their efforts to assure that moneys collected by the counties for the state are properly remitted on a timely basis.

Unnecessary Duplication of Records

Section 91-4437, R.C.M. 1947, prescribes that copies of court orders determining inheritance tax be sent to the State Board of Equalization, treasurer, and others. The Board of Equalization files the orders and uses them to account for the taxes received. In the case of the treasurer, however, the orders are not used, but are merely filed until such time that the file becomes full, whereupon the older orders are disposed of. There appears to be no practical reason for the treasurer to receive copies of these documents. These and other unused documents collectively necessitate unnecessary handling and storage.

RECOMMENDATION

We recommend that the treasurer:

- 1. Examine its files to identify records which are duplicative or unused such as the court orders for inheritance tax.*
- 2. Seek legislation during the next legislative session to delete the provisions of law requiring the treasurer to receive unneeded records.*

STATE TREASURER AS TREASURER OF ALL AGENCIES

Section 79-306, R.C.M. 1947, provides that "the state treasurer is hereby designated as the treasurer of each and every state board, commission, bureau, department and state institution, now existing or hereafter to be created or established." Irrespective of the requirements of this law, our examination disclosed that in many instances, state funds are being received and disbursed by many agencies outside of, and without the cognizance of the treasurer. In numerous other instances, the treasurer is notified of fund transactions only after the fact.

For example, at least \$46,400,000 in investments was not shown on the treasurer's records at December 31, 1969, because agencies such as the Teachers' Retirement Board, Public Employees' Retirement Board, Industrial Accident Board, and others failed to notify the treasurer of investment transactions.

Likewise, at least \$7,700,000 in bonded debt was not shown on the treasurer's records at June 30, 1969, nor were the transactions such as periodic debt payments shown. This debt consisted of bond issues at Eastern Montana College and Northern Montana College and for the most part, the treasurer was aware of the deficiency in the treasury records, but was uncertain as to the amount.

The various university units also have many accounts which receive and disburse money which also is not reflected on the treasurer's records. For example, at June 30, 1969, only 26 percent (\$430,000) of the total \$1,700,000 in unrestricted funds at the University of Montana was reflected on the treasurer's records, while a similar condition existed with respect to restricted funds, in which only 4 percent (\$18,000) of the total \$463,000 was shown on the treasurer's records.

We believe that the above examples serve to illustrate two basic points: (1) Provisions of law are not being adhered to, and (2) The state treasurer is not the state treasurer, in the sense that significant state moneys never pass through the treasury. Disregarding the requirements of law, we believe the present condition is indeterminately detrimental to state government and precludes a more efficient and planned governmental operation. The absence of central fund management, accounting control, and just plain visibility poses a multitude of problems in budgeting for and reporting the results of operations, as well as the biennial task undertaken by the legislature to prudently finance governmental operations.

RECOMMENDATION

We recommend that the treasurer and state controller:

- 1. Determine the extent to which agencies are receiving, using, and disbursing state funds without recognition in the treasury and central accounts.*
- 2. Determine the effect and application of Section 79-306, R.C.M. 1947, upon such funds by consulting with the attorney general.*
- 3. Initiate appropriate action to bring the funds outside the state treasury under proper treasury and accounting control.*

DISBURSEMENTS

Although the majority of state payments are made through the use of state warrants, significant disbursements are made by a number of state agencies by

means of their own checking accounts. At the present time, at least five agencies draw funds on the treasury through the use of 16 separate checking accounts. The checks drawn on these accounts are not centrally issued and are not a part of the state's claim/warrant system. During 1968-69, for example, over \$100,000,000 was disbursed by state agencies such as the Teachers' Retirement Board, Public Employees' Retirement Board, Employment Security Commission, Industrial Accident Board, and Liquor Control Board through the use of their own checking accounts. Although these payments were eventually recorded on the treasury records, an unknown time lapse was always present and over 16 different types of checks were issued.

In May 1968, the attorney general provided the state controller with an opinion which clearly established the authority of the controller to require all state agencies to make all payments by state warrants, pursuant to his responsibilities under Section 82-110, R.C.M. 1947. No action has been taken since that time, however, to identify or curtail the disbursement of funds through the use of agency checks rather than state warrants.

The use of these various checking accounts poses several problems for the treasurer and state controller: (1) Funds are being disbursed from the treasury in possible conflict with Article V, Section 34, of the Constitution and Section 79-202, R.C.M. 1947; (2) These checks must be manually processed by the treasurer each day, as compared to use of data processing equipment to a certain extent for warrants; (3) Financial control by the controller and treasurer is completely after the fact and therefore nonexistent; and (4) It is virtually impossible for the treasurer, state controller, and others to prepare and perform an accurate cash flow analysis because of incomplete accounting data and unknown quantities of outstanding checks.

We believe that there are very few instances, if any, where the agency's use of a checking account beyond contingent revolving accounts might be justified. In these instances, and all other instances it appears to us that the use of state warrants would require a number of insignificant administrative adjustments which are presently within the discretion of administrative officials.

RECOMMENDATION

We recommend that the state controller:

- 1. Consult with the treasurer and other agencies to identify and assess the use of agency checking accounts rather than state warrants.*
- 2. Exercise the statutory authority given him under Section 82-110, R.C.M. 1947, and the attorney general's opinion of May 16, 1968, to require the discontinuance of agency checking account systems and require the use of state warrants.*

Compiling of Disbursement Amounts

At the present time state warrants and checks processed and paid by the banks are delivered to the treasurer directly from the banks each day. In processing these items, the banks compile a daily total of state items upon which the treasurer draws a check in favor of the bank to redeem the state items. Upon receiving the state items, the treasurer "proofs" the bank totals, sorts the items into warrant and non-warrant items, and forwards the warrants to the state data processing center where the disbursements are tabulated by fund, and a listing prepared. The listing as well as the warrants are returned to the treasurer where the non-warrant items

are manually incorporated on the listing with the result being the basis for entry of disbursement data into the treasury and accounting records.

Frequently the totals compiled by the bank contain errors such as transpositions, non-state items, etc., and as a result, the check drawn by the treasurer in redemption of the items may be more or less than the actual amount of state items processed by the bank. Accordingly, the bank totals have to be verified or proofed. The proofing process commences each day upon receipt of the state items from the banks, and basically consists of a manual tabulation of all the items, one by one, using adding machines. Normally, five of the six people in the treasurer's office participate in this process which takes about a total of 10 to 15 hours each day.

Important as the verifying of bank totals is, we believe the present system of compiling disbursements is cumbersome and archaic. It may have worked satisfactorily in the past, but with the type of data processing equipment and techniques now available, and the fact that banks can provide increased services, as well as the fact that the volume of warrants is increasing rapidly, we believe some system changes are mandatory. We can see no reason, for example, why the verifying or proofing of bank totals could not be entirely done by the use of state data processing equipment. No doubt there will continue to be bank errors, as well as data processing errors, but since the state will be conducting business with the bank infinitely, such errors could be rectified in much the same manner as they are with business and personal checking accounts.

RECOMMENDATION

We recommend that the treasurer collaborate with the banks and state controller to devise a system whereby bank totals are proofed and disbursements compiled through the application of data processing techniques.

Direct Charging of State Accounts

As described above, state warrants and checks are paid (cashed) by banks in Helena each day. On the following day the state treasurer telephones the banks and is informed of the total amounts paid by the banks during the preceding day. Using this information the treasurer writes a check to the bank, on a state account in the bank, and delivers it to the bank to redeem the state warrants and checks. The delivery of the treasurer's check by the treasurer constitutes, in effect, the same process that occurs in a normal business or personal checking account wherein the bank automatically charges the customer's account for checks paid. In the state's instance, however, the bank does not automatically charge the state accounts, but rather, receives another check from the treasurer which is then charged against the state accounts. As previously mentioned, the proofing process frequently discloses that the amount of the treasurer's check is wrong, and to correct it the treasurer telephones the bank and advises them orally, to revise the amounts on the face of the check, which the bank does manually.

The present system results in (1) additional paper to be accounted for by the treasurer, (2) a serious weakness in internal control which permits the bank to amend a negotiable instrument which, if amended incorrectly, may not be discovered for 30 days or more, and (3) a unique process which causes additional work for the bank.

As in the previous matter, we can see no reason why the bank-state relationship cannot be the same as most bank-business relationships. The banks should be permitted to charge the state accounts directly, either by item or total, for state warrants, checks, and other items processed and paid by the banks. The state has adequate accounts in the banks and these accounts are fully secured by collateral pledged by the banks.

In analyzing this matter, we discussed both the present and proposed systems with representatives of local banks, federal bank examiner, and Offices of the Attorney General and State Controller. None of the officials contacted pointed out any legal or practical objections to the proposed system. To the contrary, the bank representatives expressed the belief that such a system would facilitate their present processes, while both the bank and attorney general's representative had serious reservations about the propriety of the present practice permitting the banks to amend state checks.

RECOMMENDATION

We recommend that the treasurer cooperate with the local bankers in establishing a system in which state warrants, checks, and other items are automatically charged against state accounts, and the treasurer immediately notified.

SUSPENSE AND CLEARANCE ACCOUNTS

On October 1, 1969, the state controller abolished most cash suspense accounts and established in their place, clearance accounts in the Federal and Private Grant Clearance Fund. These accounts were established by the controller in response to our recommendations in earlier audit reports (Fish and Game Commission, August 1968 and Board of Equalization, July 1969). The purpose of our recommendation and the state controller's action was to provide accounting recognition and control over the suspense account transactions.

During the course of our audit, we found that the Secretary of State's Office was still using a suspense account as opposed to a clearance account and as a

result the transactions relating to this account are not recorded in the state's central accounting system. We also noted that the treasurer was maintaining three other accounts which functioned in much the same manner as suspense accounts and which were also not reflected in the state's central accounting system. These accounts are: the Liquor Control Board Revolving account, Highway Safety Responsibility Deposits account, and the Water Conservation Debt Service Series #2 account. In all, the total balance in these four accounts at December 31, 1969, was \$148,578.

After discussion with the principal officials involved and analysis of the nature of these accounts, as well as the transactions in each, we can see no valid reason why the accounts should remain outside of the state's central accounting system.

RECOMMENDATION

We recommend that the state controller establish accounting control in the state's central accounting system for:

- 1. The Secretary of State suspense account*
- 2. The Highway Patrol Safety Responsibility Deposits account*
- 3. The Liquor Control Board Revolving account*
- 4. The Water Conservation Debt Service Series #2 account*

Need For a Clearance Account

The division of weights and measures of the State Department of Agriculture frequently brings checks to the treasurer and exchanges them for two or more treasurer's checks. This is done because the division occasionally receives amounts in excess of the amount due the state and as a result a refund is

necessary. By obtaining treasurer's checks, the division is able to make the necessary refund, and deposit the remainder in the proper state account. It is transactions of this type which are best served by a clearance account.

RECOMMENDATION

We recommend that the state controller:

- 1. Confer with the treasurer to identify other instances similar to that described above.*
- 2. Establish a clearance account to handle the transactions for the division of weights and measures, and other agencies having similar transactions.*

Long Outstanding Checks

The treasurer has not established a policy with respect to canceling checks (as opposed to warrants) which have been outstanding for abnormally long periods. As a result, a large number of checks have been outstanding for one year or more with most of the checks outstanding over two years. In most instances, these checks were drawn on suspense accounts which have since been discontinued, although a number of them were also drawn for the weights and measures division of the State Department of Agriculture.

Although recent legislation provides for the cancellation of state warrants after one year, this policy has not been extended to treasurer's checks as recommended in one of our earlier reports (Board of Equalization, July 1969). As pointed out in that report, the file of outstanding checks should be periodically reviewed as a matter of routine practice and if respective payees cannot be located, all checks over one year should be canceled.

RECOMMENDATION

We recommend that the treasurer periodically review the file of outstanding checks and cancel all those checks over one year old for which the payee cannot be located.

INVESTMENTS

The treasurer's responsibilities with respect to investments are basically twofold. First, the treasurer is charged by Sections 79-1208 and 81-1008, R.C.M. 1947, to act as custodian of all state investments, maintaining whatever records necessary to account for investments and, secondly, the treasurer, as a member of the State Depository Board has been responsible for the investment of surplus treasury cash.

The prime purpose of our examination was to test and evaluate the records and operations of the treasurer's office. Since, however, the investment activity within the state is dispersed among several agencies, it was necessary for us to expand our examination to encompass the investment function of several other agencies, including the Department of State Lands and Investments, Industrial Accident Board, Public Employees' Retirement Board, Teachers' Retirement Board, and several other smaller agencies.

Our examination disclosed two basic facts: (1) The state is losing unknown sums of investment income because of an absence of a formalized and aggressive investment function, and (2) The investment activity of the state is largely decentralized and virtually void of formalized accounting control. The specific comments with respect to these points as well as other significant matters are presented below.

Quarterly Report of State Depositories

Section 79-810, R.C.M. 1947, specifies that banks must provide the state with a quarterly report showing the amount of money on deposit during the quarter as well as any interest paid, credited, or allowed. The statute also prescribes that a certification accompany the statement, showing that no inducement or reward has been offered or made in exchange for the deposit of state funds.

No such reports are being submitted by the banks in accordance with the provisions of this law.

RECOMMENDATION

We recommend that the treasurer design a form in which the prescribed report can be conveniently made and require a quarterly report from the bank in compliance with the provisions of law.

Demand Deposit Balances

State funds on deposit in Montana banks are generally found in two categories, namely time deposits and demand deposits. Time deposits are sums of state money placed in a bank for a specified period of time, for which the bank issues a certificate of deposit and upon which the bank pays interest. Certificates of deposit (CD's) are not available for immediate withdrawal by the state and for all practical purposes, are a form of investment of state moneys.

In contrast to time deposits, demand deposits are not invested funds. Money in demand deposit accounts is subject to withdrawal by check or other means and does not draw interest. In most instances, the amount of money in demand deposits should be predicated upon the need for such money to cover outstanding checks and

warrants. The extent to which demand deposit balances exceed the needed amounts represents, in our opinion, under-utilization of state funds.

Demand deposits of state funds are maintained by the treasurer in 136 banks around the state. The primary purpose for such accounts is to provide the state a convenient method of depositing in the state treasury. Once deposited, however, the money loses its identity and is commingled for investment purposes, although the treasurer, state controller, and agency maintain records reflecting the funds and accounts involved.

Historically, the balance of demand deposits has remained extremely high while the amount invested in CD's has been relatively static and low. This is illustrated by the following table:

<u>AVERAGE MONTH END BALANCE</u> <u>CD's AND DEMAND DEPOSITS</u>		
<u>Fiscal Year</u>	<u>CD's</u>	<u>Demand Deposits</u>
1968	\$8,752,000	\$23,678,000
1969	8,817,000	27,137,000
1970 (to 2/28/70)	8,901,000	25,281,000

The treasurer does not use a systematic means of determining what the level of demand deposits should be, such as in relation to outstanding warrants or other probable cash requirements. The emphasis has been for the treasurer seeing that the demand deposit balances in each bank are adequate to reimburse the bank for its services, and assuring that the balances do not exceed the amount of collateral pledged by the bank as security for public deposits. There is no indication that the balance of demand deposits was related to cash requirements, nor was there any indication that a conscious effort was being made to manage treasury cash in a

manner conducive to optimum use of cash resources. In short, there is little in the way of a treasury cash management program, other than receiving and paying cash and as a result, enormous sums of money are left on deposit in non-interest bearing accounts.

There is no sound business reason why a large portion of the treasury cash could not be invested in CD's or short term securities. We believe that if the treasurer briefly examined the historical trend of cash outflow and inflow in combination with predicted cash requirements, it would be found that a large portion of the treasury cash currently in demand deposit accounts could be invested in CD's or other investments without any detrimental effects on the cash position of the treasury. It is not difficult to visualize the benefits which would be derived from this action. For example, had the treasurer been able to invest at least \$2,000,000 of the \$27,000,000 in demand deposits on hand during calendar year 1969 in CD's at the nominal rate of 5 percent for one year, at least \$100,000 in revenue would have been earned. We believe that much more than \$2,000,000--possibly as much as \$20,000,000 could have been invested without any adverse effect on the state's cash position.

RECOMMENDATION

We recommend that the treasurer develop a systematic means of analyzing the treasury cash in demand deposit accounts to determine the amounts necessary to meet the cash requirements of the state.

Compensating Balances

The large cash balance in demand deposits are due, in part, to an informal policy practiced by the treasurer wherein compensating balances are left in each

bank. In theory, compensating balances are those amounts of state moneys placed in banks to reimburse the banks for banking services rendered to the state. Theoretically, the banks are able to use the state money in the course of their business and in doing so earn revenue which compensates them for banking services provided to the state.

The treasurer has not attempted to identify or determine the cost of services performed for the state by banks, which are what the banks should be compensated for. To do so would require an identification and assessment of the various services provided by the banks, the value of such services, and a determination of the deposit balance necessary to fairly compensate the bank for these services.

Generally, the treasurer establishes compensating balances primarily as a reaction to demands by the respective banks, the only constraint being the amount of treasury cash available for deposit. To a certain extent, the treasurer also rationalizes the existence of large compensating balances from the standpoint of economic benefits, a view which is shared by the banking community. Here the contention is that state deposits in the banks constitute loanable funds which provide indirect benefits to the state as a whole, such as corporate income taxes and increased property and other taxes as a result of the additional income generated by state deposits. Commenting on this aspect in their 1964 report on investments, the Legislative Council concluded that although some economic benefits may accrue to the state "the state cannot be expected to sacrifice an appreciable portion of interest income under the somewhat uncertain expectation of additional tax collections. According to the Council, it is not clear that the deposit of state funds in banks will generate more income and more taxes, while it is clear that excess compensating balances result in a sacrifice of interest income to the state.

We concur with the Council in that we believe the primary interest of the treasurer should be the optimum use of state cash resources. We were unable to find any tangible relationship between the balances in the various banks and bank services or economic benefits. We found that the majority of the banks provided the state with only basic services such as night depository, receiving of state cash, and the infrequent paying out of state cash.

The treasurer was unable to identify economic benefits to the state as a result of its demand deposits, nor to discern any relationship between bank services and the demand deposits. To the contrary, the demand deposit balances of state funds in most of the banks appeared to be far in excess of those amounts reasonably necessary as compensating balances. Examples of such balances are presented in the following table which shows the average balance in selected banks as well as the highest and lowest balances during 1969.

<u>Demand Deposit Balances in Selected Banks During Calendar Year 1969</u>			
<u>Bank</u>	<u>Average Balance at End of Month</u>	<u>Highest Balance</u>	<u>Lowest Balance</u>
A	\$ 45,061	\$ 63,033	\$ 39,468
B	26,310	40,089	16,117
C	365,305	787,596	251,945
D	106,943	203,950	50,613
E	452,135	1,124,927	299,370
F	30,917	38,416	23,416
G	76,131	110,643	50,841
H	7,122,185	11,275,199	2,705,217
I	8,570,567	13,665,997	2,440,213

We believe that the amount of state funds left on deposit in Montana banks should relate directly to demonstrable services and economic benefits. No attempt has been made to determine whether the benefits are worthy of the cost; the benefits being the bank services and economic returns and the cost being the forfeiture of interest income. At the present time there is no evidence to indicate that the present level of compensating demand deposit balances are justifiable in view of tangible benefits. Rather, the opposite appears to be more realistic; i.e., present balances are not justified when bank services, economic benefits, and potential interest income are considered.

RECOMMENDATION

We recommend that the treasurer:

- 1. Analyze the actual services performed for the state by banking institutions around the state and establish a price for these services on the basis of the most favorable treatment accorded commercial businesses by banks.*
- 2. Establish a formula for determining the amount of demand deposit moneys necessary to compensate the bank for its services on the basis of factual data.*

Statutory Requirements for Collateral

Section 79-301, R.C.M. 1947, provides that depository banks must pledge collateral in an amount at least equal to the amount of state funds on deposit. The apparent purpose of this collateral requirement is to give the state a preferred status in the event of liquidation of the depository bank and to otherwise provide security for state deposits. Paragraph 2 of the statute provides a

description of the type of securities which the treasurer will accept as collateral such as bonds of the federal government or its agencies, bonds and warrants of the State of Montana, general obligation bonds of other states, etc. The statute also contains a provision which provides that " . . . bonds issued in the United States of America, which are quoted on the New York market . . . shall be acceptable at not to exceed ninety per centum (90%) of such market quotation . . ." The intent and meaning of this provision are not clear in the statute. It is uncertain as to whether the treasurer is required to accept and recognize only 90 percent of all bonds pledged as collateral, or only 90 percent of certain types of bonds. It is also unclear as to whether the collateral should be accepted at market value or at face value. For example, the market value of U. S. treasury bonds fluctuates from day to day. In one instance a \$100,000 U. S. treasury bond due in 1973 had a market value in January 1969 of only \$87,400. The question is, at what value should the treasurer recognize the bond as collateral: par value of \$100,000; market value of \$87,400; or 90 percent of market value, which in the example would be \$78,660. Heretofore, the treasurer has accepted only federal securities and obligations of Montana and its political subdivisions as collateral, at 100 percent of face or par value.

The treasurer contends that the use of market value, as suggested by the statute, would pose an unwieldy bookkeeping problem since the market value of bonds fluctuates daily. We believe that state deposits should be properly collateralized and that the treasurer should comply with the provisions of law and, where necessary, seek clarification of the law.

RECOMMENDATION

We recommend that the treasurer seek clarification of Paragraph 2 of Section 79-301, R.C.M. 1947, either through an opinion by the attorney general or, if necessary, legislation.

Demand Deposits In Excess of Collateral

Regardless of the implications of Paragraph 2 of Section 79-301, R.C.M. 1947, as discussed in the preceding section, the banks are required to maintain collateral in the amount of the state deposits. In the past the treasurer has accepted pledged collateral at 100 percent of its face or par value. To insure that the balances of demand deposits in the banks do not exceed the collateral amounts, the treasurer periodically reviews the bank balances and draws them down when necessary. According to the treasurer, there is no established routine for making this comparison, but it is done to the extent necessary to keep the balances below the collateral limits.

Using the treasurer's procedure of recognizing collateral at face value, we tested the bank deposit records for 26 of the 136 banks having state deposits. Our test disclosed that at least 9 banks had exceeded the collateral at one time or another within the past six months. In several instances some of the bank's balances were in excess of collateral many times.

The reasons for the excess were not apparent in the records nor could the treasurer adequately explain why the conditions existed except that they were exceptions. Irrespective of the reason for the excess balances, we believe the treasurer should fully enforce this statute provision. In our opinion, a more

systematic and formal approach is necessary to adequately assure that collateral is not exceeded.

RECOMMENDATION

We recommend that the treasurer institute a formal daily procedure whereby the balances of demand deposits are compared to collateral to detect and prevent instances where deposits exceed collateral.

Certificates of Deposit

Certificates of deposit, or CD's, are a form of investment in which the bank exchanges a certificate for a sum of money upon which the bank agrees to pay interest over a predetermined period. For the most part the maturity period, denomination, and interest rates on CD's are regulated by the federal government. Banks are able, however, to competitively adjust the interest rates within the perimeters set by the federal government and as a result, the offering of CD's by banks is often a competitive thing.

In the past it has been a general policy of the state to invest in one or more CD's from each of the banks doing business with the state. To a certain extent this policy has been advocated by the State Depository Board as an indirect economic measure to assist the banks throughout the state. In practice, however, the treasurer is the state office which negotiates with the banks in acquiring CD's, makes the actual investments, and monitors the CD's until maturity.

Interest rates on CD's are directly correlated to a number of factors such as the maturity period, denomination, and the interest rate the banks are willing to pay. Generally speaking, however, the larger the denomination of the CD, and the longer the maturity period, the greater the interest rate will be. Therefore, with

other factors considered equal, a greater return is available on CD's in large denominations for longer maturity periods, than on smaller CD's for shorter periods. The relationship between these factors is shown in the following table:

Current
Interest Rates on CD's

<u>Maturity Period</u>	<u>Annual Interest Rate</u>	
	<u>Under</u> <u>\$100,000</u>	<u>\$100,000</u> <u>& Over</u>
1 month to 2 months	0	6.25%
2 months to 3 months	0	6.50%
3 months to 6 months	0	6.75%
6 months to 1 year	5.00%	7.00%
1 year to 2 years	5.50%	7.50%
2 years and over	5.75%	7.50%

Source: U. S. Federal Reserve System - Regulation "Q" dated 1/20/70.

As of December 31, 1969, the treasurer was holding approximately \$9,000,000 in CD's. These CD's were distributed among 125 of the 136 Montana banks doing business with the state and ranged in denomination from \$4,000 to \$900,000, with the maturity periods ranging from 3 months to one year.

We believe the state is losing considerable sums of potential interest income because of the current practices of the treasurer with respect to CD's. Prior to the time of our examination, the treasurer did not have information as to the maximum interest rate available on CD's. As a result, we found a number of instances where the treasurer was holding CD's which were paying less than the maximum interest rate available at that time. Based upon our analysis of these CD's, we estimate that in excess of \$33,500 in potential interest income could

have been realized over the maturity period of the CD's if the maximum available interest rate had been obtained. Some examples illustrating the basis of this estimate are as follows:

Certificates of Deposit
Comparison of Actual
and Potential Interest Rates

	<u>CD Number</u>	<u>Annual Interest Rate</u>		<u>Potential Amount Lost</u>
		<u>Actual</u>	<u>Potential</u>	
1.	19	4.0%	5.0%	\$ 500
2.	433	4.0%	4.5%	100
3.	2662	4.0%	5.0%	300
4.	7218	4.5%	5.0%	125
5.	16551	4.5%	5.0%	200
6.	369	4.0%	5.0%	342
7.	2152	5.0%	6.25%	625
8.	12602	5.0%	6.25%	1,562
9.	11530	5.0%	6.25%	11,250
10.	4727	5.0%	6.25%	938

The above comments and table relate primarily to the additional interest income that could have been earned over the term of the CD's on hand at December 31, 1969. Our analysis also disclosed that over the longer period of August 1966, to February 1970, the state could have earned \$250,000 more in interest income on CD's if the banks had paid the maximum interest rate allowable on CD's. For the most part, this is attributable to the lack of the treasurer being continually cognizant of the most optimum CD's and to negotiate effectively with the banks. There has been no meaningful negotiation process between the treasurer and the banks with respect to CD's.

We also found no attempt on the part of the treasurer to obtain the most optimum CD's, i.e., large denominations for long maturity periods, nor to cycle or deliberately schedule CD's to permit a predictable and even flow throughout the year. The majority of the \$9,000,000 in CD's held by the treasurer at December 31, 1969, consisted of denominations of \$50,000 or less having maturity periods of 6 months or less. Discussion with treasury officials disclosed that this condition existed because of essentially the same reasons enumerated above, i.e., lack of information by the treasurer and ineffective negotiation with the banks. In addition, the treasurer expressed a seemingly valid reluctance to commit large sums of treasury cash for extended periods of time. In this regard, we found that most of the CD's matured at random times throughout the year without a plan or deliberate schedule. It would not be difficult, in our opinion, to schedule or cycle the investment in CD's so as to permit, at any given time, adequate cash on hand in addition to the most optimum CD's. This could be accomplished by purchasing CD's in such a manner that eventually a predictable portion of the total CD's would mature each month. For example, we believe the treasurer could take \$1.2 million, now invested randomly in CD's, and reinvest \$100,000 each month in CD's having a term of one year. The interest rate would be 7.50% and easier management and uniform cash liquidity would result from the uniform and predictable maturation of \$100,000 in CD's each month.

In discussing this aspect, the state treasurer expressed the belief that a practice such as that described above would preclude smaller banks from participating and result in a concentration of CD's in larger banks. Since this practice

is untested we are not certain that the effect described by the state treasurer would occur. Even if it did it would not be a significant change from the present situation in which 70% of the total amount of CD's are concentrated in 39 banks in 14 Montana cities.

In summary, we believe that much can be done by the treasurer to effectuate a greater utilization of the treasury cash invested in CD's. The treasurer can accomplish this by assuming a more businesslike approach in its relationships with banks and in the management of CD's.

RECOMMENDATION

We recommend that the treasurer:

- 1. Periodically contact the local branch of the Federal Reserve Bank to obtain accurate information relative to CD's.*
- 2. Negotiate with the banks in a businesslike manner on the basis of the Federal Reserve Bank information, to obtain the maximum interest rate allowable on CD's at all times.*
- 3. Evaluate the present investment in CD's to identify the action necessary to cycle or schedule the investment in CD's so as to result in:*
 - (a) The most optimum CD's*
 - (b) Uniform maturity of CD's each month*
 - (c) Desirable cash liquidity at any given time*
 - (d) The minimum amount of bookkeeping effort*

Investment in General Fund Warrants

Periodically during the year it becomes necessary for the state to invest its own cash in warrants which were drawn on the General Fund (hereafter referred to as general fund warrants). This action is prompted by the lack of correlation between General Fund income and expenditures. Large expenditures are made from the General Fund during the first half of the fiscal year while the majority of General Fund income is not received until the second half of the fiscal year. As a result, the General Fund is, in effect, overdrawn or put into a deficit cash position until such time that substantial General Fund income is received by the state. In the meantime, general fund warrants are paid using cash derived from other treasury funds, hence, it is commonly described as an investment in general fund warrants.

There are several questionable aspects relative to the above described process. First of all, the statutes apparently authorizing the state fiscal officers to invest in general fund warrants are unclear and possibly contradictory. Secondly, the method used to record and account for the process does not provide for a complete record of the transactions nor full disclosure of what has taken place, and lastly, the means used to determine the cash available for investment in general fund warrants, i.e., surplus treasury cash, needs clarification and refinement. Each of these aspects are addressed in the following paragraphs.

Statutory Authority

On December 23, 1969, the State Board of Land Commissioners authorized the treasurer to invest up to \$18,000,000 in surplus treasury cash in general fund warrants. This action was taken at the request of the State Depository Board which cited Section 79-1101, R.C.M. 1947, as the statutory authority for such action.

Section 79-1101, R.C.M. 1947, provides that the State Board of Land Commissioners can authorize and direct the treasurer to purchase general fund warrants whenever the commissioners believe it would be advantageous and there are not sufficient funds in the General Fund to pay such warrants. The statute provides that the commissioners will designate the amounts and funds from which the cash will be invested and will notify the state auditor who will produce and issue the warrants which will be physically marked to indicate and give notice that the state has a right to purchase those warrants. The statute further provides that when the warrants are presented for payment the treasurer will pay the warrants out of the proper fund designated by the commissioners and that when paid in this manner, the warrants will be registered and bear interest as provided by law. This section of law infers, in our opinion, that the investment of other treasury funds in general fund warrants is a deliberate and preplanned process, in which specific moneys in other funds are used to temporarily make up a deficit in the General Fund.

Section 79-1202, R.C.M. 1947, specifies that surplus cash in the Office of the State Treasurer may be invested in registered warrants and that such warrants will not bear any interest. This provision presupposes that the treasurer will have cash which is surplus, but fails to define the meaning and extent of surplus cash.

In contrast to the above statutory provisions, Section 79-208, R.C.M. 1947, provides that the treasurer must pay state warrants upon presentation, out of funds available for such payments. In the event there are no moneys available for payment upon presentation of a warrant, the statute directs the treasurer to register the warrant in a book or register and make an endorsement on the face of

the warrant to the effect that the warrant was presented for payment but not paid because of lack of money. In this connection, the statute provides that all such warrants registered and endorsed shall bear interest at the rate of 4% per annum and shall be redeemed and paid in the order of registration. There is no question, in our opinion, that this provision of law intends that when cash is not available for payment of warrants, the treasurer must refuse to pay the warrants, and should record and pay interest on the warrant until sufficient funds are available, at which time the warrants will be redeemed in order of presentation.

The relationship between Sections 79-1101, 1202, and 208, R.C.M. 1947, is not clear. Although the commissioners authorized the treasurer to invest in general fund warrants, no guidance was given to prescribe the funds from where the cash would be derived, as required by Section 79-1101, nor were the warrants prepared and issued in a preplanned manner as inferred by the same statute. Each provision of law relating to the investment in general fund warrants also specifically prescribe that such warrants shall be registered. Section 79-208, R.C.M. 1947, further provides that when registered, the warrants will be subsequently redeemed or paid in order of registration. In the past, however, the warrants have not been registered nor have they been paid or redeemed in the sequence in which they were acquired. In short, there is a substantial lack of compliance with the statutory provisions insofar as the investment, registration, and redemption of general fund warrants is concerned. We believe this stems from the fact that the provisions of law are unclear and possibly contradictory. In this regard, we have discussed the entire area of investment in general fund warrants with the Attorney General's Office which concurred in our belief that clarification of the statutes is essential.

RECOMMENDATION

We recommend that the treasurer consult with the attorney general to:

- 1. Seek legal clarification of the relationship and effect of the statutes governing the investment in general fund warrants, namely, Sections 79-208, 79-1101, and 79-1202, R.C.M. 1947.*
- 2. Identify instances where additional statutory authority is needed and, in conjunction with the attorney general, request the legislation necessary to effect such authority.*

Accounting Process

The process by which the investment in general fund warrants is made is in actuality nothing more than a bookkeeping technique. The warrants have already been drawn on the General Fund by the state auditor and paid by the treasurer using treasury cash which is commingled in the bank accounts. Because there is technically no cash in the General Fund, the treasurer does not post or record the selected general fund warrants to the treasury records or state accounting records, but rather holds them in the vault until the balances in the General Fund becomes sufficient to cover them. As a result of this process, the state auditor's records show a deficit or overdrawn balance in the General Fund while the treasurer's records show a positive balance. For example, on January 31, 1970, the state auditor's records showed a deficit balance in the General Fund of \$14,700,000 while the treasurer's records showed a positive balance of \$2,900,000. The difference of \$17,600,000 is comprised of \$1,200,000 in general fund warrants which are outstanding, i.e., had not been presented to the state

for payment, and \$16,400,000 in general fund warrants held by the treasurer as an investment.

As previously described, the treasurer does not register the general fund warrants held as an investment nor is there any listing showing the nature of the warrants held. The treasurer merely selects the warrants each day and withholds them from the bookkeeping process and places them in the vault. In order to ascertain the nature of the warrants, or their respective numbers, it is necessary to physically examine each warrant. Similarly, the treasurer does not redeem or pay the warrants in the order in which they were acquired. Instead, the treasurer makes a determination of how much General Fund cash is available, and then selects a number of warrants corresponding in amount to the cash available. Throughout the process, the only record created constituting a form of accounting control are ledger cards maintained by the treasurer showing the dollar balance of general fund warrants being held at any given time. The balance of general fund warrants held by the treasurer is not reflected in the accounting records maintained by the state controller, nor is any formalized accounting control exercised over the transactions constituting the investment of treasury cash in general fund warrants.

We believe that a system of accounting for the investment in general fund warrants should be instituted. The nature and amount of general fund warrants should be reflected in the accounting records as a liability of the General Fund representing the amounts withdrawn from the other funds. There should be a clear presentation of the transactions involved, namely, borrowing from other treasury funds to temporarily finance the General Fund, as well as the subsequent repayment to the other treasury funds when General Fund cash becomes available.

RECOMMENDATION

We recommend that the treasurer consult with the state controller to institute formal procedures whereby the transactions constituting an investment in general fund warrants are properly recorded, disclosed, and accounted for as part of a formalized accounting process.

Surplus Cash

Although the investment in general fund warrants has ostensibly been made under the authority of Section 79-1101, R.C.M. 1947, treasury officials also cite Section 79-1202, R.C.M. 1947, as an underlying authority. Section 79-1202, R.C.M. 1947, specifies that surplus cash in the treasury may be invested in registered warrants and that such warrants will bear no interest. This statute presupposes that the treasury will have cash which is surplus, but nowhere in the statutes is the intent and meaning of surplus cash defined. Treasury officials advised us that there was no formal definition of surplus cash but that they considered surplus cash to be that money not needed to pay current expenditures. Reasonable as this definition sounds, the treasurer was unable to demonstrate any tangible relationship between cash on hand and current expenditures. Such factors as the amount of outstanding warrants, cash flow analysis, or other similar studies of treasury cash do not enter into the determination of surplus cash.

We believe some measures are necessary to clearly identify the composition of treasury cash and define that amount which is surplus treasury cash. This is especially important in view of the fact that some cash in the treasury is restricted by its very nature or by statute from being used for such purposes as investing in general fund warrants. For this reason, we believe it is imperative

that the treasurer develop a systematic means of analyzing treasury cash to disclose its origins, whether or not it is restricted or needed to meet current expenditures, and whether it can be used to purchase general fund warrants.

RECOMMENDATION

We recommend that the treasurer:

- 1. Develop a systematic means of identifying the fund source and composition of treasury cash.*
- 2. Confer with the state controller and attorney general to formulate a proper and legal definition of surplus cash.*
- 3. Utilize a systematic procedure in conjunction with the above definition to identify the extent to which treasury cash is surplus and available for investment in general fund warrants.*

Cause of Investment in General Fund Warrants

Each year in December and June, the State Board of Education distributes the state public school equalization fund to local governmental units in control of school districts. The purpose of this distribution, as described in Section 75-3612, R.C.M. 1947, is to provide an annual minimum operating revenue for elementary and high schools in each county for the payment of costs as provided by law. The money distributed comes from two sources, namely, a statutory percentage of certain taxes and royalties collected by the state and the General Fund. In December 1969, the fund distribution of \$20,109,239 consisted of about \$4,800,000 from the tax and royalty source and over \$15,000,000 from the General Fund. Because the General Fund balance was not adequate to meet this distribution, the treasurer

was required to pay the general fund warrants with cash derived from the other treasury funds. As a result, approximately \$15,000,000 of the \$16,500,000 in general fund warrants held by the treasurer on January 31, 1970, represented payments to the state school equalization fund.

Although the semi-annual distribution of school funds is prescribed by Section 79-3616, R.C.M. 1947, the actual amount distributed is controlled by the Board of Education. In the recent past it has been administrative policy of the board to distribute 40% of the funds in June and 60% of the funds in December. This distribution has historically caused a cash shortage in the General Fund at the most inopportune time, i.e., when the General Fund is nearly depleted of cash.

An analysis of the need for money at the school district as well as the rationale behind the State Board of Education's policies and practices is a matter beyond the scope of this examination. Nevertheless, we did examine the matter to the degree necessary to demonstrate that, although required by statute, the timing of the semi-annual distribution of school funds is detrimental to the General Fund cash position and undermines any meaningful attempt at effective cash management at the state level. We also suspect that the semi-annual distribution may not be in the best interest of the school districts themselves in that costs and expenses are incurred throughout the year and the influx of state funds may not be correlated with these expenses. There is also indication that once distributed to the school districts, especially the smaller districts, the state funds lie idle in bank accounts until needed to meet expenses. If so, we believe it is completely unwarranted in a practical sense, as well as poor budgetary practice for the state to exhaust its General Fund only to leave the funds idle at a sub-state level.

We believe that the treasurer, Offices of the State Controller, Superintendent of Public Instruction, and the Board of Education should cooperate with the county school officials to ascertain the action necessary to correlate the distribution of state school funds with actual need at the school level.

RECOMMENDATION

We recommend that the treasurer contact the state controller, superintendent of public instruction, and the Board of Education to identify and take whatever joint action necessary to correlate the distribution of state school funds with actual need at the school level.

Identification of Interest Earnings

The treasurer maintains records of investments showing maturity date, interest date, and amount of interest income due or received. Some of the investments shown on the treasurer's records are registered in the name of the treasurer as an agent for various funds and agencies, while other investments are registered to the agencies. Because of this the treasurer frequently receives interest earnings payments in the form of checks from the paying agents for the various investments. Upon receipt of these checks the treasurer forwards the check to the appropriate agency for identification and eventual deposit in the treasury. After associating the check with a specific investment, the agencies return the check to the treasurer for deposit in the proper account in the treasury.

Because of the above described procedure, money is not being deposited promptly upon receipt in accordance with basic internal control standards, and interest earnings on the undeposited amounts are not being earned. For example, we noted an instance in which an interest check of \$125,312 was received by the treasurer on Thursday, May 14, 1970. The treasurer forwarded the check to the agency who identified the interest earnings and returned the check to the treasurer on Friday, May 15, 1970. Subsequently, on Monday, May 18, 1970, the treasurer deposited the check in the bank, and the cash was available for investment. As can be seen, this one example resulted in over \$125,000 floating outside of the treasury cash accounts for at least three days. Had an aggressive investment program been in effect, this entire amount could have been invested to provide the state with additional interest income. We believe this example illustrates the adverse monetary effect and poor control of the present process.

In our opinion, interest checks such as that described above could be deposited in a clearance account and the agency notified. Upon proper identification, the funds could be transferred to the proper account by a journal entry. This would result in proper control and the cash being immediately available to the treasurer for investment.

RECOMMENDATION

We recommend that the treasurer deposit interest checks in a clearance account upon receipt and, when appropriate, transfer the funds to the proper account by journal entry.

Unrecorded Investments

As prescribed by Sections 79-306 and 79-1208, R.C.M. 1947, the treasurer is ostensibly the custodian of all state securities and investments. The treasurer retains custody of investments and maintains detailed records purportedly reflecting the investment balances of the state.

Our examination of the investment accounts disclosed, however, that in excess of \$65,500,000 in state investments were not shown at December 31, 1969, on the treasurer's records nor on the state accounting records maintained by the state controller. These records showed that the balance of state investments on December 31, 1969, was \$156,254,077, when in fact the actual balance was \$212,769,661.

For the most part, the understatement consisted of investments in mortgages, buildings, treasury bills and bonds, and certificates of deposit, although a number of other investment transactions such as unamortized premium or discounts, redemptions or trades, and investment earnings also contributed to the understatement. The understatement of \$65,500,000 is attributable to the following agencies and functions:

<u>Agency/Function</u>	<u>% of Total</u>	<u>Amount</u>
1. Teachers' Retirement Board	37.35	\$24,471,288
2. Public Employees' Retirement Board	32.12	21,041,935
3. State Treasurer (CD's and U. S. Treasury Obligations)	29.23	19,155,285
4. Industrial Accident Board	1.11	724,554
5. World War I Veterans Compensation Bond (Earnings)	.07	47,361
6. Game Wardens' Retirement System	.06	36,642
7. Montana Judges' Retirement System	.06	36,323
8. Social Security Agency Account	<u>.00</u>	<u>2,196</u>
Total Investments Not Recorded	<u>100.00%</u>	<u>\$65,515,584</u>

We found that the understatement was basically caused by two separate, but related factors: (1) the failure of investing agencies to promptly advise the treasurer of all investment transactions, and (2) the failure of the treasurer to properly record all investments, including its own.

As cited in our report on the Department of State Lands and Investments (June 1970), a number of agencies are conducting their own investment programs. We believe this practice to be contrary to the intent and provisions of law, as discussed in that report, and that it is not in the best interests of the state with respect to proper fund management, accounting control, and full financial disclosure. In the instance at hand, the absence of effective accounting control has resulted in agencies making over \$65,500,000 in investments without any evidence of such transactions on the investment records of the treasurer or the state accounting records. This also points out the false sense of control provided by the duplication of records between the treasurer,

state controller, and state auditor. In this case, the treasurer's records were seriously understated, but since the treasurer supplies the controller and auditor with investment data, their records were correspondingly understated. Because of this, the periodic news releases by the state auditor on the investments of the state are erroneous. For example, at December 31, 1969, the auditor advised the public through a news release that the state's investments were \$156,000,000 when in fact the actual invested balance was in excess of \$212,000,000.

We believe that timely and proper recording of transactions is basic if the state is to effectively control and manage the resources for which it is responsible, and that meaningful and accurate financial statements are entirely dependent upon such recording. As long as state agencies continue to function outside of the central state processes, proper recording of transactions and meaningful and accurate financial statements will never be achieved. Basic and simple statements about the condition of state resources, such as the periodic news release of the state auditor described above will also be erroneous and misleading because of incomplete and incompatible data.

Because of the failure of agencies to timely and properly report investment transactions to the treasurer and other state agencies, and in view of the serious distortion of the state's investment balances, we believe prompt action is warranted by the treasurer and state controller under Sections 79-306, 79-1208 and 82-110, R.C.M. 1947, to prescribe and install uniform accounting and reporting systems with respect to investments by state agencies. These systems should include, as a minimum, basic principles and standards governing the valuation of investments, amortization of premiums and discounts, and the flow of transaction data from the agencies to the treasurer and state central accounting function.

RECOMMENDATION

We recommend that the treasurer and state controller take prompt action to prescribe and install an accounting and reporting system for all state investments.

Investment of Idle Funds

As previously pointed out in the sections of this report dealing with demand deposits (page 30), compensating balances (page 32), and certificates of deposit (page 38), substantial amounts of state funds are idle or not put to optimum use either because the treasurer has no means of determining the extent to which funds are in excess of current requirements or because the treasurer attempts to maintain an arbitrary cash balance. We found, for example, that up to \$27,000,000 in cash was being held in non-interest bearing demand deposit accounts without any tangible relationship to need, and that the state's cash position was not systematically analyzed nor evaluated to determine the optimum use of cash resources. No cash flow analysis or other examination of the relationship between available cash and cash requirements has been made with respect to treasury cash or the overall cash resources of the state, and as a result, none of the state fiscal officers can accurately determine the extent to which cash is required for operations, or the extent to which cash is available for investment or more optimum use. In all fairness to the treasurer and other fiscal officers of the state, information and data such as this is generally the product of an aggressive cash and investment program involving cash forecasts, cash budgets, and continuing cash flow analysis, all of which require specialized attention. For this reason, we recommended in our

report on the Department of State Lands and Investments, June 1970, that the state acquire specialized investment talent to manage the state's investment portfolio and utilize cash resources to the maximum extent. Before such a program can be effective, however, deliberate measures will have to be taken to identify the cash available for investment. Accordingly, we believe the treasurer and state controller should initiate action on a statewide level to examine and analyze the inflow and outflow of cash to determine the predictable cash position of the state, the amount of cash necessary for day-to-day operations, and the amount of cash available for investment.

RECOMMENDATION

We recommend that the treasurer and state controller devise a system of cash flow analysis for the state whereby the cash available for investment from day-to-day is identified.

Payment of Matured Interest Coupons

Among the investments held by the treasurer as custodian are Teachers Retirement Board investments. Our examination of the securities comprising these investments disclosed two instances where interest coupons on the securities had not been clipped and presented for payment in a timely fashion. Coupons having a total value of \$11,406, representing interest earnings on railroad trust certificates were not clipped and presented for payment until March 17, 1970, though they had matured in January and February 1970.

We believe it is poor business practice for the state not to collect interest earnings as soon as they are available. The failure to collect interest promptly when earned results in state assets being left idle and unutilized.

RECOMMENDATION

We recommend that the treasurer take appropriate action to insure that all interest coupons are presented for payment at maturity.

Request For Investment Authorization and Approval

As observed and reported in our report on the Department of State Lands and Investments (June 1970), the Teachers' Retirement Board does not seek the authority or approval to make investments from the land board. Similarly, the Public Employees' Retirement Board and the Industrial Accident Board do not seek authority or approval from the land board until after the investment transactions have been consummated. As a result, the constitutional and statutory responsibilities of the land board are being circumvented, and the state's investment function is diffused and decentralized to the point that there is duplication in effort and administration, lower grade investment services, and less than the maximum investment of state funds.

We addressed this problem in our land department report and concluded therein that the separated and individual investment functions now existing to be contrary to law. We recommended the land board and State Department of Administration seek to create a centralized investment function with the expertise necessary to achieve the intent of the investment statutes. Our examination of the investment accounts maintained by the treasurer provides additional support, in our opinion, for a uniform and central investment program such as prescribed in the statutes and recommended above. For this reason we are rephrasing and restating our recommendation here.

RECOMMENDATION

We recommend that the land board, treasurer, and State Department of Administration cooperate to establish a central investment authority, headed by an expert in the investment field, to achieve maximum use of investable state funds and provide for uniform recognition and accounting for state investments.

Amortization of Investment Premium or Discount

When an investment security is purchased the investor frequently pays a premium or receives a discount with respect to the value of the security. Premiums represent amounts paid in excess of the par value of a security while discounts generally refer to the amount paid below par value for the security. Both premium and discount are affected by the current market rate of interest and represent an adjustment of the interest rate and therefore the monetary value of a security. Premium and discounts should be amortized over the term of the respective securities so that interest earnings on investments are properly recognized in the accounting records. There are two generally accepted ways of amortizing premiums and discounts: the straightline method or the scientific method.

As pointed out in our report on the land department, state agencies currently use a variety of methods in accounting for premium and discounts. The methods vary from a direct writeoff with no amortization to a form of straightline amortization. Because of the variety of methods used to amortize investment premiums or discounts, an indeterminable distortion of investment balances and earnings results. This distortion is incorporated in the treasurer's investment accounts.

RECOMMENDATION

We recommend that the state controller prescribe procedures and instruct investing agencies in the use of a uniform method of amortizing investment premiums and discounts.

GENERAL FIXED ASSETS

The treasurer does not adequately account for fixed assets under its control. Control accounts for fixed assets have not been maintained and the amount of fixed assets under the treasurer's control is not a matter of written record. Assets have not been marked or otherwise identified, periodic physical inventories have not been taken, and additions and deletions have not been recognized in formal accounting records. In summary, no accounting control exists over general fixed assets.

The state controller recently issued Management Memorandum No. 70-10 which deals in part with the proper recording of fixed assets. We recommend the treasurer should initiate a system of accounting for fixed assets within the terms of the controller's memorandum, as well as other generally accepted accounting principles.

RECOMMENDATION

We recommend that the treasurer:

- 1. Take a complete physical inventory of its fixed assets and assign and attach identification numbers to all equipment.*
- 2. Establish a value (actual cost, if possible) for each item.*
- 3. Establish general ledger control accounts for fixed assets with a supporting detail ledger showing detail data as to date of acquisition, cost, description, serial number, location and identification number.*

4. *Record additions and deletions in the ledgers on a timely basis.*
5. *Take annual physical inventories in the future and adjust the records to agree with equipment actually on hand.*

CONTRACTOR DEPOSITS

Procedures

In the past it has been a customary practice for the state and other contracting entities to retain about 10 percent of interim contract payments due to public contractors to insure timely and proper completion of contract work. The net effect of this was that the state was holding, interest free, significant sums of money which was eventually paid to the contractor. This was a poor arrangement from a contractor's viewpoint, in that a portion of his entitlement under a contract was not available to him and was not drawing interest.

As a means of overcoming this aspect, the legislature enacted Chapter 94, Laws of 1969, which allows contractors under contract to the state or any political subdivision of the state, to deposit certain governmental securities with the treasurer in substitution for that portion of contract payments due the contractor, but retained by the state as an incentive for satisfactorily completing the contract.

In practice, the responsibility of overseeing contractor deposits is shared by the treasurer and the contracting agencies. The treasurer receives and places a value on securities deposited by the contractor, notifies the contracting agency of such, and retains the securities in the treasury vault. In some instances,

the contractors have deposited the securities with banks which in turn provide the treasurer with a receipt as evidence of safekeeping.

Since implementation of the legislation in July 1969, the treasurer has received in excess of \$3,000,000 in securities deposited by contractors. As might be expected, these deposits are eventually released or transferred to other projects as the original projects are satisfactorily completed. Because the law is relatively new, a clearly defined and well designed set of procedures and practices has not yet been implemented. We found a certain amount of confusion, lack of understanding, and a variety of forms with respect to the act of making such deposits with the treasurer. Although the treasurer has devised and is using a uniform document to notify the contracting agency of a contractor deposit, no formal instructions or forms have been developed for the use of contractors who wish to make deposits. As a result, there is no consistency in the form and type of deposits made by contractors. Some contractors send in complicated self-devised forms with their deposits, while others forward simple forms and still others telephone the treasurer with inquiries about deposits. In one instance a contractor furnished as a deposit, a certificate of deposit in a bank although the law specifically requires certain governmental securities and the treasurer accepted the certificate of deposit as an acceptable deposit even though it did not meet the requirements of law.

RECOMMENDATION

We recommend that the treasurer:

- 1. Design and provide contracting agencies with forms and instructions governing contractor deposits forwarded to the state as well as safekeeping receipts provided by banks for contractor deposits.*

2. *Accept only the securities prescribed by law as contractor deposits.*

Escrows and CD's as Contractor Deposits

At the present time only U. S. Treasury obligations and bonds or notes of the State of Montana or its political subdivisions are acceptable under the law as contractor deposits. In practice, most contractors do not post Montana obligations as deposits, but rather have in the majority, purchased for deposit U. S. Treasury notes, bills, and bonds. The apparent reason for this is the availability of such securities and the relatively high interest return.

Our discussions with representatives of the Montana Contractors' Association and treasurer disclosed that serious consideration should be given to bank escrow accounts and certificates of deposit as alternative forms of deposit. Escrows and CD's would be attractive from the standpoint that they would simplify and reduce the record keeping function by making more flexible denominations available, obviate the necessity to determine whether the value of the security is adequate to cover the contract, provide the contractor with a number of alternatives, and potentially assist the economy of local areas by providing the banks with a new source of lending capital.

We believe the use of escrow accounts and CD's has considerable merit. Their use would tend to retain deposit money in the state rather than outside the state, as is the case now with U. S. Treasury obligations. Although the use of CD's and escrow accounts would require new legislation amending Section 82-4101, R.C.M. 1947, we believe such action should be seriously considered.

RECOMMENDATION

We recommend that the treasurer confer with the Montana Contractors' Association and determine the relative merit and desirability of amending Section 82-4101, R.C.M. 1947, to include escrow accounts and CD's and, if warranted, seek the necessary statutory changes during the next legislative session.

ABANDONED PROPERTY ACCOUNTS

In 1963, the legislature enacted the Uniform Disposition of Unclaimed Property Act (Chapter 244, Laws of 1963) which provided for the disposition of unclaimed property or property presumed to be abandoned. The act establishes criteria to be used in determining when property is presumed to be abandoned and sets up a reporting and collection system in which abandoned property is reported and eventually collected by the state.

Generally, the act provides that ~~any~~ personal property held by banks, financial organizations or business associations as custodians for others, who have not indicated an interest in such property for seven years, will accrue to the state. Upon receipt of this property, the treasurer is required to deposit the proceeds in the Trust and Legacy Fund, public school account, but is authorized to retain up to \$25,000 for the purposes of paying subsequent claims for abandoned property. The statutes permit an unlimited amount of time in which the original owners of property that has reverted to the state can recover the monetary value of the property by making a claim to the treasurer.

The prime responsibility for identifying, collecting, and processing abandoned property in Montana lies with the abandoned property division of the treasurer.

The division, in fact, consists of only one individual whose salary and expenses are funded by an appropriation from abandoned property moneys. The collection of abandoned property has represented a significant source of revenue to the state. Since the enactment of the legislation in 1963 through June 30, 1969, in excess of \$747,000 had been collected by the state, of which \$525,000 has been transferred to the public school account. Our examination of the abandoned property function disclosed, however, that serious weaknesses in the identification, reporting and collection processes may have resulted in failure of the state to collect all abandoned property. These weaknesses are discussed in the following paragraphs.

Identification of Abandoned Property

We found that the process by which abandoned property is initially identified is basically uncontrolled and not reliable. Holders of abandoned property are required by Section 67-2211, R.C.M. 1947, to file periodic reports with the treasurer. To facilitate the reporting, the abandoned property division mails copies of reporting instructions and forms to potential holders of abandoned property. In the case of life insurance companies, banks, financial organizations, and cooperatives, the instructions and reports are mailed annually and the holders are required to respond annually. In the case of all other holders such as business associations, the instructions and reports are mailed every three years and the holders are required to respond every three years.

In the past the division has constructed its mailing list from two basic sources. The Office of the State Auditor provides a listing of all insurance companies doing business in the state, while the State Board of Equalization furnishes a listing of all corporations in Montana. On the basis of this information, the division mails each business entity a four-page set of instructions and two copies of the report form which is to be notarized and returned to the division.

No record is maintained to show to whom the documents were sent and as a result the abandoned property clerk was unable to estimate how many instructions and report forms are sent. The volume must be very large considering that the names provided by the state auditor and board of equalization include most of the larger businesses in the state.

Since the division does not maintain a record of the forms periodically mailed out, the abandoned property clerk does not know the extent to which businesses have completed and returned the reports, although the report forms indicate that recipients should respond as to whether or not they have abandoned property. The abandoned property clerk and deputy treasurer estimated that about 90% of the reports actually returned to the treasurer do not show the existence of abandoned property. As a result, it would appear on the surface that the time consuming and costly efforts of the division are, for the most part, unproductive. In actuality, however, this is not so, for in calendar year 1969 alone over \$71,000 in abandoned property was collected by the state at an estimated cost of about \$8,000, almost a 9:1 ratio of benefits to cost.

Because of the historical and potential significance of this program, and the fact that the state is the legal custodian of abandoned property, we believe steps should be taken to improve and simplify the identification, reporting and collection of abandoned property. In our opinion, a refined system of identifying and recording the existence of abandoned property is necessary to assure that all abandoned property is collected as required by law. Such a system should include a refinement of the instructions and report forms, as well as the mailing lists to correlate to the maximum extent, the mailing of forms with the potential holders of abandoned property. The system should also include a cumulative record of

reports mailed and returned and a cumulative record of abandoned property collected. Because of the large volume, the state's data processing equipment could be effectively utilized for most of these tasks, as well as automatic mailing. We believe the costs of such a change would be more than offset by increased collections.

RECOMMENDATION

We recommend that the treasurer:

- 1. Seek the advice and assistance of the Department of Administration, management systems unit and central processing division to design and implement a more refined and automated means of identifying, recording, and collecting abandoned property.*
- 2. Establish a central record over forms mailed to businesses and followup on those businesses which do not properly respond as required by law.*

Verification of Abandoned Property

Our examination disclosed that there is no independent assurance that businesses holding abandoned property are reporting it to the state as required by law. The extent to which the existence of abandoned property is reported to the state is at present entirely dependent upon the holders of such property. No effort is made to examine businesses to verify the accuracy of their reports or the basis of no report, even though Section 67-2223, R.C.M. 1947, provides the treasurer with the authority to make such examinations. As previously mentioned, the present abandoned property function consists of only one clerk who has been unable to completely meet the requirements of the abandoned property statutes.

Irrespective of the provisions of Section 67-2223, R.C.M. 1947, however, we do not believe the treasurer is the best office for the responsibility to verify and enforce compliance with the abandoned property statutes. The treasurer's primary function is as custodian of state moneys, while the collection and enforcement of the laws relating to such moneys involves seeking out and securing the payment of funds to which the state is entitled which is more suitable as an operating agency function.

Moneys secured from abandoned property sources accrue to the Trust and Legacy Fund, which is under the control of the Department of State Lands and Investments. Accordingly, the effort to identify and collect abandoned property may be more relevant to that agency, as is the case in the State of Oregon. On the other hand, the State of New York retains this function within the State Controller's Office which has audit and control capability. In any event, we believe some form of verification or examination is necessary, as apparently did the legislature when they enacted Section 67-2223, R.C.M. 1947. Accordingly, we believe that some action should be taken to relocate and properly staff the abandoned property function to assure maximum compliance with the Uniform Disposition of Unclaimed Property Act. To effect such a relocation amendatory legislation will be necessary. We believe the treasurer should initiate and cooperate with the Department of State Lands and Investments and the state controller to effectuate such legislation.

RECOMMENDATION

We recommend that the treasurer initiate the appropriate action and cooperate with the Department of State Lands and Investments and the state controller to properly locate and staff a function in which the duties and responsibilities associated with abandoned property are properly performed in accordance with law.

Timely Reports of Abandoned Property

Section 67-2225, R.C.M. 1947, provides that any person who willfully fails to render any report or perform the duties required under the abandoned property statutes shall be fined \$50 for each day such reports are withheld, but not to exceed \$1,000. The same statute also provides that anyone failing to remit abandoned property as required shall be fined from \$100 to \$1,000 or imprisoned for not more than six months, or both, in the discretion of the court.

The above described penalties are mandatory and are not within the treasurer's power to disregard. Nevertheless, there are numerous instances where individuals have failed to respond with reports as required by law, but no action has been initiated to assess the penalties. For example, we noted a number of instances where banks, businesses, and insurance companies did not report abandoned property until June 1969, even though the property had been abandoned as early as 1957, and should have been reported in 1964 when the law became effective. We also found an instance where a bank had properly filed annual reports up to October 1967, but has failed to file any report since then, even though the treasurer has corresponded with them regarding the matter.

Although the law requires that penalties be assessed, the treasurer has not initiated action for non-compliance with the statutes. We believe this is merely another aspect indicating that a forceful administration of the abandoned property laws is needed.

RECOMMENDATION

We recommend that the treasurer identify those instances where individuals fail to report or remit abandoned property in accordance with law and initiate appropriate action to insure filing of the reports as prescribed in the statutes.

Accounts Receivable

Currently the abandoned property division has no formal record of abandoned property accounts receivable, i.e., what has been billed for remittance, remitted, or not remitted. The existing records consist of files of abandoned property reports, a folder in which abandoned property amounts billed are filed, and a ledger card showing total receipts over the years. In order to ascertain the extent to which abandoned property has been billed, but not remitted, the abandoned property clerk has to tabulate the individual amounts. As a result, formal control over abandoned property due the state is almost non-existent. As an example of what can happen without formal control, we found two instances where abandoned property reports were misplaced for several years and as a result the remittance was not sought until recently.

RECOMMENDATION

We recommend that the treasurer establish formal accounting control over abandoned property amounts due the state, with subsidiary records to show the extent to which items have been billed, remitted, or not remitted, and items which have been identified but not billed.

Contents of Safe Deposit Boxes

Section 67-2202, R.C.M. 1947, provides that any funds or other tangible or intangible personal property removed from a safe deposit box or any other safe-keeping depository for lack of payment of rental fees, which meets the criteria as abandoned property, must be reported and collected by the treasurer as abandoned property.

In substantial conformance with the law, holders of abandoned property in safe deposit boxes have been reporting such to the treasurer. To date, however, the treasurer has not collected the contents of safe deposit boxes other than

money and as a result considerable amounts of apparently valuable abandoned personal property remains uncollected. We found numerous instances where items such as savings bonds, certificates of deposit, and some cash have been reported as abandoned but not collected by the treasurer. We also found a number of other personal property items which do not have an inherent value, but nevertheless may be of extreme value to others. A partial list illustrating the type of items disclosed by our tests is presented below:

<u>Description</u>	<u>Amount</u>
409,000 shares of Sun Oil Trust certificates	Unknown
33 fully matured U. S. Savings Bonds	\$1,090
2 Postal Savings Certificates	1,000
2 Certificates of Deposit	250
10 shares of Wrigley Pharmaceutical	Unknown
26,600 shares of Inland Oil & Gas Co.	Unknown
1 convertible gold note	50
1 gold bond	50
2 envelopes of cash	25
1 antique watch	Unknown
1 1851 one-cent piece	Unknown
7 gold rings	Unknown

Our tests also disclosed the existence of numerous items such as homestead and mining claim certificates, life insurance policies, property deeds, corporate shares and many other items, some of which may be of significant value. None of these items have been collected by the treasurer, who has statutory authority to do so and sell them at public auction.

We believe it is completely inappropriate for the treasurer to disregard the existence of abandoned personal property. Doing so results in the failure of the state to collect what it is entitled to under the law and subjects these items to potential misappropriation or conversion by the holders or others who know of their existence.

RECOMMENDATION

We recommend that the treasurer initiate action to collect and sell all items of personal property, reported as abandoned property and having any potential value.

Highway Safety Responsibility Deposits

In reviewing the "Safety Responsibility Act" records at the Highway Patrol offices in conjunction with our examination of the treasurer, we noted that many deposits meet the criteria of abandoned property, i.e., older than seven years with no intervening activity. For example, we found one deposit of \$108 made in 1954, and two other deposits of \$200 and \$150 made in 1955, in addition to many similar examples.

We believe the treasurer should take action to collect **these** items. We were informed that the necessary forms have been sent to the Highway Patrol, but no followup or collection has been made.

RECOMMENDATION

We recommend that the treasurer:

- 1. Contact the Highway Patrol and collect all deposits in their custody which qualify as abandoned property.*
- 2. Identify and contact any other state agencies which may have similar deposits and collect those which qualify as abandoned property.*

Abandoned Common Stock

In accordance with the statutes, a corporation operating in Montana reported 56 shares of their common stock as abandoned property in October 1967. To this

date no action has been taken by the treasurer although the value of this stock is well established. On June 9, 1970, for example, these shares were worth \$1,500.

RECOMMENDATION

We recommend that the treasurer collect and liquidate this stock in accordance with the applicable statutes.

Sale of Abandoned Property

Section 67-2217, R.C.M. 1947, provides that all abandoned property delivered to the treasurer shall be sold within one year of receipt at public auction. We found that the treasurer has been holding for many years a \$25 savings certificate and 2 shares of common stock having a market value of \$750. There appears to be no reason for the continued retention of this property in view of the above cited statute.

RECOMMENDATION

We recommend that the treasurer sell all abandoned property in accordance with the provisions of law.

Remittance of Deposits Without Interest

Section 67-2204, R.C.M. 1947, provides that abandoned customer deposits held by utilities should be reported and remitted to the treasurer as abandoned property, in addition to any interest paid on these deposits while they were held.

We noted that at least one utility, which is currently paying interest on its consumer deposits at the rate of 6%, has not included the interest amounts with its remittance of abandoned consumer deposits.

RECOMMENDATION

We recommend that the treasurer:

- 1. Contact this utility and determine the value of interest paid on consumer deposits but not remitted.*
- 2. Seek the remittance of all interest amounts in compliance with Section 67-2204, R.C.M. 1947.*

Abandoned State Moneys

Our tests disclosed that a number of financial institutions were holding moneys which belong to various state agencies, but which qualify as abandoned property, as defined in the statutes. We found, for example, that two banking institutions had reported the following amounts as abandoned property.

<u>State Agency</u>	<u>Amount</u>
Fish and Game Commission	\$ 65.00
Department of Law Enforcement	25.00
Liquor Control Board	54.00
Board of Health	2.00
State Treasurer	144.98
Board of Equalization	<u>200.00</u>
Total	<u>\$490.98</u>

Because of the insignificant amounts involved, we made no attempt to ascertain the source and background of these amounts. It is of particular interest to us, however, why and how the agencies involved permitted these amounts to lapse to the point that they qualified as abandoned property and, with certain exceptions, were collected as such. The collection of state moneys as abandoned property

results in the funds being applied to use under the public school fund rather than the appropriate agency funds.

Although Section 67-2211, R.C.M. 1947, provides that the holders of abandoned property are supposed to attempt to locate the owner of the property presumed abandoned, there is no specific requirement for the treasurer to do so but the treasurer has occasionally notified the agency of the abandoned property and they have usually claimed it.

RECOMMENDATION

We recommend that the treasurer:

- 1. Advise holders of abandoned property of their responsibility under the statute to locate and notify the owners of abandoned property, if possible, especially in the case of state agencies.*
- 2. Notify state agencies of any abandoned property amounts reported to the treasurer which appear to be within the ownership of these agencies.*

Service Charges

We noted several instances where various banks and other financial institutions reporting and remitting abandoned property to the treasurer have assessed service charges against the property and reduced it accordingly. In some instances these charges appeared to be reasonable, but in other instances we believe they were unreasonable.

Commercial banks, however, are permitted by the banking laws to assess a "reasonable charge" for accounts under their control and in the banking industry

this charge is usually applied at varying rates according to banking officials to draw the accounts down as a means of reducing the possibility of embezzlement. We were advised by the State Examiner's Office and a representative of a local bank that if the owner reappears the banks normally refund the entire amount without a service charge.

The treasurer has not formulated a policy with respect to service charges, and as a result, some banking institutions are reducing the amounts remitted to the state by assessing service charges which, in our opinion, are unreasonable. We believe the state should receive the same amount that would be given the owner, should he reappear. This is not presently the case, however, for some banks assess a service charge of \$2 per year while other banks charge \$1 per month. In one instance a bank assessed a service charge of \$76.67 against abandoned property totaling \$79.43, leaving only \$2.76 to remit to the state. In another instance the same bank levied charges of \$84 against \$706.

We question the propriety of this action on the part of the banks, especially if they would refund the entire amount to the owner should he reappear. Accordingly, we believe the treasurer should, under the authority granted by Section 67-2226, R.C.M. 1947, formulate rules and regulations relating to the assessment of service charges on abandoned property accounts.

RECOMMENDATION

We recommend that the treasurer formulate specific rules and regulations governing the assessment of service charges by holders of abandoned property.

Distribution of Abandoned Property Proceeds

Section 67-2218, R.C.M. 1947, provides that all funds collected as abandoned property shall be deposited by the treasurer in the Trust and Legacy Fund, public school account ". . . except that the state treasurer shall retain in the Agency Fund (Unclaimed Property Account) an amount not exceeding twenty-five thousand dollars (\$25,000.00) . . ." for the purpose of paying subsequent claims.

As of March 30, 1970, the balance in the agency account was \$158,449. Analysis of the account disclosed that in the past two years the balance has never fallen below \$100,000.

This inappropriately high balance resulted from two factors. First, the treasurer's records show only the amounts paid into the account, but not out. As a result, the treasurer has a cumulative record of deposits and does not know, without checking the state controller's records, what the balance of the account is. Secondly, treasury officials expressed a belief that they wanted to retain sufficient funds in the account to pay claims made by the owners of property paid to the state as abandoned but were unable to demonstrate that the \$25,000 set by law was insufficient to pay such claims.

RECOMMENDATION

We recommend that the treasurer:

- 1. Transfer the amount of the Unclaimed Property Agency account in excess of \$25,000 to the Public School Permanent Trust and Legacy account as provided for by law.*
- 2. Review the account balance monthly and make transfers as necessary to keep the account balance at or below \$25,000.*

ESCHEATED ESTATES

Escheated estates differ from abandoned property to the extent that abandoned property represents money accruing to the state because the owner's whereabouts is unknown whereas escheated estates represent money accruing to the state because the owner died leaving either no known heirs, or heirs who refuse to accept the property or heirs who cannot receive the property because of legal obstacles. Both escheated estates and abandoned property are similar in that once the legal criteria has been satisfied, the amounts in both accounts are transferred by the treasurer to the public school permanent account.

There are basically three accounts having to do with the matters related to escheated estates: (1) the undistributed estates agency account (No. 912600), representing amounts transferred to the treasurer by the counties because the heirs cannot be located, are minors, are incompetent, etc., with a balance on June 30, 1969, of \$4,227; (2) escheated estates agency account (No. 912700), consisting of \$253,950 at June 30, 1969, which had accrued to the state because there were no known heirs; and (3) the alien heirs agency account (No. 915700) with a balance of \$38,972 at June 30, 1969, resulting from estate proceeds willed to heirs living outside of the United States in nations which either do not reciprocate with the U. S. in inheritance matters, or restrict the inheritance of money by United States citizens.

Definition of Responsibilities

We found that confusion exists regarding the responsibilities of the treasurer and Office of the Attorney General relative to escheated estates. Section 91-612B, R.C.M. 1947, provides that it is the responsibility of the treasurer to credit moneys to the escheated estates accounts, account for them and transfer them to

the appropriate funds in accordance with law. Section 91-512, R.C.M. 1947, describes the duties of the attorney general as being the legal advisor to the treasurer, but also states that the attorney general is to make investigations and conduct inquiries to assure that all proper moneys are escheating to the state.

In practice the treasurer has maintained records showing the amount of receipts of escheated estates, incomplete data on disbursements, and to a certain extent legal records relating to trusts and estates accruing to the state under the escheat laws. The attorney general has no records on escheated estates, except for administrative claims. As a result, the question as to whether escheated amounts are properly received, accounted for, and periodically transferred to the proper accounts cannot be answered, except on an exception basis. The entire matter is further clouded by the fact that the statutes governing the various types of escheated property are overlapping and unclear. For example, Section 91-520(4)(h), R.C.M. 1947, provides that the property will escheat after 3 years. As a result of this obvious confusion and as an example, we found where action was taken by a previous state treasurer on the basis of her interpretation of law, only to be later reversed by the attorney general on the basis of his interpretation of the law. Legally appropriate action would have been taken initially if the two offices had established their responsibilities relating to escheated estates. Similarly at the present time, the treasurer is confronted with decisions as to the disposition of properties in the escheated estates accounts which are clearly contingent upon legal ramifications.

We believe the attorney general and treasurer should make a cooperative effort to identify their respective responsibilities under the escheat laws and establish

ground rules governing the work to be done and records to be maintained by each with respect to the present escheated amounts and future escheated property.

RECOMMENDATION

We recommend that the treasurer and attorney general collaborate to identify and resolve their respective responsibilities under the Escheated Property Act.

Accounting for Escheated Estates

Partially as a result of the conditions described above, and for other reasons, the treasurer does not have adequate records to account for the transactions in the escheated estates account. We found, for example, that at December 31, 1969, the treasurer's records showed \$1,227,201 in account number 912700 (escheated estates agency account) even though the actual amount in that account was only \$267,527. The difference of \$959,647 represents disbursements made by the state controller and attorney general but not recorded by the treasurer. The treasurer maintains records showing only the amounts that have been deposited to the account, the cumulative balance, and those disbursements or transfers initiated by the treasurer's office. Appropriations from the account for the Office of the Attorney General and journal vouchers initiated by the controller are not shown. As a result, the treasurer's balance is greatly overstated and unrealistic.

We believe the treasurer, pursuant to his statutory responsibilities to account for the escheated estates account, should confer with the state controller and establish accounting records necessary to accurately account for receipts and disbursements to the escheated estates account.

RECOMMENDATION

We recommend that the treasurer consult with the state controller and establish the records necessary to properly account for the escheated estates account.

Inheritance Tax

Our test of various records maintained by the treasurer disclosed a possibility that amounts in alien heirs accounts have been eventually paid to heirs by the treasurer without any collection of inheritance tax. For example, we found one instance where \$7,990 was paid to the state under the alien heirs statutes, held by the treasurer for a period of time and then paid to the alien beneficiaries in 1960. Insofar as we could determine, no inheritance tax was collected on this transaction. Discussion with an official of the State Board of Equalization's inheritance tax division disclosed that, although they were aware of the alien heir statutes, they were not aware of the fact that the treasurer was making payments to alien beneficiaries. The tax official stated that the state inheritance tax applies to alien beneficiaries in the same manner and extent that it does to Montana residents. He said that before any such payments are made by the treasurer, the Board of Equalization should be consulted so that appropriate tax measures can be applied. Insofar as he was aware, the treasurer has not consulted them in the past, therefore it is highly unlikely that the inheritance tax has been paid on payments to alien heirs.

We are uncertain of the extent to which similar payments have been made since such information would necessitate further review of the treasurer's records. Nevertheless, we believe this point illustrates further, the confusion that exists with respect to the escheated estates matters. In our opinion, a matter such as this would have been detected had the transaction received proper legal review.

RECOMMENDATION

We recommend that the treasurer refer all proposed payments to beneficiaries under the escheated estate statutes to the inheritance tax division of the Board of Equalization for assessment of appropriate inheritance taxes.

Improper Payment of Escheated Money

Section 91-520(4)(h), R.C.M. 1947, provides that if action to recover money received by the state under the alien heirs statutes is not taken within 3 years or the period established by a trust, the money will escheat to the state permanently and will be beyond recovery by the heirs.

We observed an instance where \$3,332 was received by the state in 1955 as the proceeds of an estate under the alien heirs statutes. In 1960, the treasurer paid the same amount to an heir. However, we were unable to find any indication that the payment was proper in view of the 3 year limitation of the statute. As a result, we believe that the payment may have been improper since 3 years had expired and no evidence of a different period established by a trust was apparent. This is a further example of the need for proper legal review of the escheated money transactions before their consummation.

RECOMMENDATION

We recommend that the treasurer refer all proposed payments to beneficiaries under the escheated estate statutes to the attorney general for legal review.

Conflicting Statutes

Section 91-512, R.C.M. 1947, authorizes the attorney general to employ a special assistant to administer and perform certain work relative to escheated estates. According to the statute, the salary of this special assistant cannot exceed \$6,000 plus necessary expenses incurred as a part of his duties, all of which are to be appropriated from the escheated estate moneys. Notwithstanding the provisions of that statute, the 41st Legislative Session appropriated the following from the Escheated Estates moneys for the special assistant function:

	<u>1969-70</u>	<u>1970-71</u>
Personal Services	\$10,651	\$11,011
Operation	<u>8,825</u>	<u>8,825</u>
Totals	<u>\$19,476</u>	<u>\$19,836</u>

Since the appropriation legislation of the 41st Legislative Session and preceding sessions has obviously amended Section 91-512, R.C.M. 1947, we believe the \$6,000 limitation should be deleted.

RECOMMENDATION

We recommend that the attorney general seek the necessary legislative changes to delete the \$6,000 salary limitation in Section 91-512, R.C.M. 1947.

Distribution of Escheated Estate Balances

Section 91-526, R.C.M. 1947, provides that money distributed in the administration of an estate and deposited with county treasurers is to be transferred to the state treasurer upon the expiration of one year, and deposited

in the undistributed estates agency account (No. 912600). According to the statute, the treasurer is to hold it in the agency account for two years after which it is to be transferred to the Public School Permanent Trust and Legacy account (No. 810212). We found, however, that the balance of the agency account at the time of our examination was \$4,860, of which about \$4,227 had been on deposit in excess of 2 years, and therefore should be transferred to the Trust and Legacy Fund.

With respect to funds in the alien heirs agency account (No. 915700), we found a similar condition where in 1963 the state treasurer transferred the balance of the alien heir agency account to the Trust and Legacy Fund, in apparent conformance with the statutes. In 1966, this action was reversed when the state treasurer issued a journal voucher transferring the entire balance back to the agency account. The treasurer's action was taken on the basis of an attorney general's opinion which concluded that the original transfer was in error and that the balance should be in the agency account. The attorney general's opinion was apparently prompted by a claim against the alien heirs account which the treasurer refused to pay. As a result of the attorney general's opinion, the balance in the agency account at April 24, 1970, was \$38,972 of which \$38,672 has been in the account dating back to 1959.

Because of the fact that the balance in the account was relatively old, and the fact that we believe the statutes governing the disposition of escheated estates money are unclear and possibly overlapping as previously pointed out, we requested a clarifying opinion from the Office of the Attorney General. On June 12, 1970 the Attorney General's Office provided a formal opinion indicating that the

payment of moneys from the alien heirs agency account is governed by the statutes and trusts under which the treasurer received the moneys. When the time frame established by the trust expires and the moneys are still in the alien heir account, the proceeds escheat to the state. The attorney general further specified that if the moneys escheated to the state have been in the agency account for 10 years, they should be transferred to the public school permanent trust and legacy account.

On the surface, it appears that \$38,672 of the present balance should be transferred by the treasurer to the Trust and Legacy Fund. Prior to doing so, however, we believe the treasurer should consult with the attorney general and analyze the amounts in the balance to determine whether the conditions of trusts have been satisfied.

RECOMMENDATION

We recommend that the treasurer and attorney general:

- 1. Analyze the balances in the undistributed estates agency account and the alien heirs agency account to determine the appropriate balances which should be transferred to the public school permanent trust and legacy account.*
- 2. Transfer the appropriate balances.*
- 3. Cooperate in establishing a systematic means of analyzing deposits to the escheated estates accounts and periodically transferring the proper amounts to the Trust and Legacy Fund.*

BONDED INDEBTEDNESS

The treasurer's responsibilities with respect to bonded indebtedness are primarily of a record keeping nature, although the treasurer is also charged with the custody of the proceeds received from bond sales as well as Sinking Fund moneys. Sections 79-201 and 79-414, R.C.M. 1947, require the treasurer to keep an account of all moneys received and disbursed as well as an account of all the different subfunds within the Sinking Fund. Section 79-306, R.C.M. 1947, designates the treasurer as treasurer of all state agencies and requires all state agencies to deposit with the treasurer, among other things, all evidences of indebtedness.

As was the case in the area of investments, our prime purpose in examining bonded indebtedness was to test and evaluate the records and operations of the treasurer. Since, however, the bonded indebtedness activity of the state is dispersed among several agencies, it was necessary for us to encompass these agencies to a certain extent in our examination. These agencies or functions include the Water Resources Board, the State Board of Examiners, University System, and various elements of the State Department of Administration.

Our examination disclosed two basic facts which we consider detrimental to the state: (1) The formulation and creation of bonded indebtedness is widely decentralized without any common or unified effort, and (2) There is no centralized recording or accounting control over the total bonded indebtedness of the state and its agencies with the result that the state central records of bonded indebtedness are significantly understated. The underlying information and specific comments relative to these as well as other matters are presented in following paragraphs.

Accounting Control Over Bonded Debt

At the present time formal accounting recognition and accounting control over the bonded indebtedness of the state and its agencies is minimal or non-existent. Although individual agencies incurring bonded indebtedness undoubtedly have records of their indebtedness, accounting recognition and control by the central state agencies is very deficient. The records maintained by the state controller consist of a combination of manual and data processing records which together show limited information for most bond issues such as bond transactions, bonds outstanding, and Sinking Fund data. In the case of the Sinking Fund, however, the controller's records do not include the assets being held by the university units for retirement of university-related bonded debt. The state auditor's records closely resemble the controller's records insofar as type of data is concerned. In the auditor's case, however, all of the records are manually maintained.

The treasurer's records are also comprised of manually recorded data. The records maintained by the treasurer show the same data as the controller and auditor's reports, in fact, the records of these two offices are based upon data provided by the treasurer. In addition, the treasurer's records show in greater detail, the numbers and types of bonds outstanding, bond servicing data, such as principal and interest payments and bond registration information. For the most part, the treasurer's information is shown on a number of records such as ledger cards, informal records, and bond registers. The bond registers are the traditional large leather bound books which are intended to show detail information on bonded indebtedness of bond and interest coupon issued by the state and its agencies.

Irrespective of the data shown on the records described above, none of the records maintained by the state consist of the basic accounting systems used in business and recommended by the National Committee on Governmental Accounting (NCGA) of the Municipal Finance Officers Association, the authoritative source on matters of governmental accounting. For example, no system of self-balancing accounts is being used by the state to record bonded indebtedness even though this is a basic requirement of proper governmental accounting. Nor do the state records reflect all of the bonded indebtedness of the state and its agencies and have no provision for the basic features prescribed by the NCGA such as bonds authorized but not issued, amounts available for debt service, and amount to be provided for debt service. Although the treasurer's records show bond data in considerable detail such as principal and interest amounts outstanding, coming due, and paid by individual bond issue, none of this information is recorded in the controller's records which are the official accounting records of the state.

We believe a questionable situation exists insofar as the segregation of duties is concerned. Presently the treasurer has cash handling and payment responsibilities with respect to bonded debt, and at the same time, has custody of and primary recording responsibility for the official records of bonded indebtedness, and in fact, receives and handles most of the interest coupons presented by others for payment. This arrangement of duties and responsibilities results in poor control to the extent that cash handling and record keeping responsibilities are not properly segregated.

In view of the above and in the interest of proper fiscal control, we believe the record keeping functions and responsibilities now assigned to the treasurer and auditor with respect to bonded indebtedness, should be centralized in the

controller's office and that a formalized accounting system along the lines recommended by the NCGA be initiated to properly control and show the bonded indebtedness structure of the state.

RECOMMENDATION

We recommend that the treasurer and state controller collaborate with respect to bonded indebtedness to:

- 1. Devise and implement a formalized accounting system in accordance with the principles and standards promulgated by the National Committee on Governmental Accounting.*
- 2. Centralize the record keeping and accounting function in the controller's office so as to eliminate duplication of records and properly segregate cash handling and record keeping duties.*

Centralized Management and Control

During the course of our examination in the area of state bonded debt, we found that no one state official, or collective group of officials, in the present state structure occupy an overview position or have complete knowledge in the area of bonded indebtedness. Information and evidence on the extent and nature of present state indebtedness, including the type of bonds outstanding, whether they are coupon or registered and other information pertinent to effective management of the current bond debt as well as expertise in the planning and execution of prospective bond issues is dispersed over at least nine agencies. These agencies are the Board of Examiners, Department of Administration, Water Resources Board, and the six units of the University System, all of whom prepare and manage **their** own bonded debt. Because of this dispersion of authority

and responsibility, no single office or official has an overview of the state's bonded debt structure and as a result, the state and legislature are without a focal point in the case of bonded indebtedness, and must depend upon individual agency personnel and bond counsels when it comes to debt management and the planning of future bond issues.

We believe the absence of a centralized point of control over the issuance and management of bonded indebtedness in the state has contributed to a significant misstatement of the state's debt structure and uneconomical and ineffective long-term debt management in such areas as the timing of bond issues, the type of bond issued, optimum redemption of outstanding bonds and relationships with bond marketing offices.

Section 82-110, R.C.M. 1947, vests the state controller with the authority and responsibility to prescribe and install uniform accounting systems and develop plans for improvements and economies in the organization and operation of state agencies. We believe the state controller should take action pursuant to this law, to establish centralized control and expertise in the area of long-term debt management and that its responsibilities include, among other things, direct involvement in the planning and execution of all state bond issues, representing the state in all matters concerning bonded debt such as dealing with bond counsels, underwriters, etc., new issues, refunding issues, calling actions, and other matters of debt management. In our opinion, a focal point such as this would provide the state with the capability to effectively manage its existing long-term debt, evaluate various proposals and services offered by bond counsels, fiscal agents and prospective purchasers, and provide the central state government and legislature with uniform information of the state's debt structure.

RECOMMENDATION

We recommend that the state controller design and establish a centralized point of management and control over present and future state bonded indebtedness.

Utilization of Data Processing

At the present time, nearly all record keeping for bonded indebtedness is performed manually by the state controller, auditor, and treasurer. The only exceptions are a monthly listing or transaction summary showing incomplete bonded debt transactions and a yearend listing showing the activity in some of the sinking funds.

Data processing techniques are particularly applicable to an area such as bonded indebtedness where transactions such as periodic interest and principal payments must be calculated and made for many different bond issues. The use of data processing techniques to account for bonded debt, calculate periodic payments, and print periodic reports would provide more comprehensive and timely information to state officials for management and accounting purposes and should result in more effective management of the state's debt.

RECOMMENDATION

We recommend that the treasurer and state controller cooperate in utilizing data processing equipment and related techniques to account for and report bonded indebtedness.

Schedules of Bonded Debt and Maturities

Presently, no complete or routine information is prepared by the state showing the complete bonded debt structure of the state and its agencies, or

the projected maturities of bond principal and interest or the cash requirements to meet these maturities. Information as to what the debt service requirements are going to be in ensuing periods is available only on a fragmented basis for selected bond issues. For example, the university units have such information for use in budget formulation but the treasurer has similar information for only two bond issues although there are over fifty separate bond issues requiring debt service.

Accurate periodic information on the debt structure of the state and its agencies is a basic necessity for internal uses such as debt management, planning future issues, cash forecasting and fiscal planning, and is also necessary for external purposes such as the bond markets and reporting services. This information should include a statement of bonded debt showing information such as the name of the issue, statutory authority, interest and principal dates, authorized amount, bond numbers, interest rate, date of bonds, and maturity of bonds as well as a schedule of maturities showing the future maturity periods for various bonds and the cash requirements necessary to meet those maturities. In our opinion, this task could be easily performed by data processing equipment once the base data is stored.

RECOMMENDATION

We recommend that the treasurer and state controller cooperate to initiate and periodically produce statements of the total state bonded debt and schedules of maturities.

Understatement of Bonded Debt Accounts

Our analysis of bonded indebtedness records maintained by the state controller, auditor, and treasurer disclosed that the central state accounting and other

records for the state's outstanding bond debt were understated by approximately \$10,700,000. For the most part, the existence of this understatement was recognized by the treasurer and controller, although they were uncertain as to the amount. The state auditor was not aware of the understatement, however, and as a result, the publicly released balance of state bonded indebtedness was understated by \$10,700,000 at June 30, 1969, and a similar amount every month since then. The understated amounts consist of the following:

Bonded Indebtedness
Not Shown on Treasurer, Controller,
or Auditor's Records
June 30, 1969

<u>State Agency</u>	<u>Amount</u>
Eastern Montana College	\$ 5,825,000
Northern Montana College	1,875,740
Water Resources Board	<u>3,024,400</u>
Total	<u>\$10,725,140</u>

Because of the nature of the bonds involved in these issues (revenue bonds) and their underlying indenture provisions, the bonds are not as direct a debt of the state as are general obligation bonds. Nevertheless, they are part of the state's debt structure. Accordingly, we believe these bonds and all other such bonds issued by agencies of the state should be shown as a part of the state debt structure for informational as well as accounting purposes, regardless of the source of the funds used to retire the debt.

RECOMMENDATION

We recommend that the state controller and treasurer initiate joint action to record all bonded indebtedness of the state on the state's accounting and treasury records.

Cancellation of Bond Interest Coupons

Our test of paid bonds and interest coupons disclosed that bond interest coupons are not always mutilated, cancelled, or otherwise marked to prevent renegotiation. For example, we found in excess of \$14,417 in interest coupons which had been paid by the treasurer and turned over to the Office of the State Auditor for storage, and which had not been mutilated or cancelled.

Considering the volume of bonds and interest coupons processed and paid by the treasurer, the amount of negotiable coupons found as a result of our tests is insignificant. Nevertheless, they are negotiable by the holder and at various times are in the hands of numerous people other than treasury personnel. As a result, we believe the treasurer should take action to assure that all bonds and interest coupons are cancelled upon payment and the state auditor should examine bonds and interest coupons in his custody to identify and cancel any of those which may still be negotiable.

RECOMMENDATION

We recommend that the treasurer:

- 1. Examine all paid bonds and interest coupons currently on file to insure that all are appropriately cancelled.*
- 2. Institute a procedure to assure that all paid bonds and interest coupons are mutilated or cancelled upon payment in the future.*

Use of Fiscal Agent

In the area of bonded indebtedness, fiscal agents are those banks or trust companies which, for a fee, act as a paying agent for the state by paying state

bonds and interest upon presentation by the holder. At the present time, two basic methods of using fiscal agents are employed by the state. In one instance, the treasurer remits moneys to the fiscal agent in advance of the date upon which state bonds and interest coupons are due. The fiscal agent then makes payment from these funds as the bonds and coupons are presented.

In the second and contrasting instance, the treasurer does not remit the funds to the fiscal agent in advance, but rather reimburses the fiscal agent for bonds and interest coupons which it has paid. This reimbursement is usually made by the treasurer through a local bank using the correspondent bank process.

In each of the methods, the fiscal agents assess a charge against the state for the services rendered such as collecting and paying the bonds and coupons. The charges levied by the current fiscal agents under the two methods are illustrated in the following table:

Charges by Fiscal Agents
Paying State Bonds and Interest Coupons

<u>Fiscal Agent</u>	<u>Fee For Each Item</u>		
	<u>Coupons</u>	<u>\$1,000 Bonds</u>	<u>\$5,000 Bonds</u>
Treasurer Remits in Advance			
Fiscal Agent A	12 1/2¢	\$2.00	\$2.00
Fiscal Agent B	12 1/2¢	\$1.50	\$1.50
Treasurer Reimburses Fiscal Agent			
Fiscal Agent C	12 1/2¢	1/10 of 1%	\$1.50

Analysis of the above table discloses at least two basic points: first, the charge for such services varies from fiscal agent to fiscal agent, and is apparently a competitive matter. Secondly, contrary to what one might envision, the state is paying a larger fee in those instances where the treasurer remits

the money to the fiscal agent in advance, than in the instance where the treasurer reimburses the bank. Aside from this fact, the reimbursement method is also attractive, in our opinion, from the standpoint that the state retains the use of the moneys until the bank seeks reimbursement for presented bonds and coupons, where in the other method the state loses the use of the moneys since they are remitted to the bank in advance of the principal and interest due dates. In addition, bonds and coupons are often presented for payment directly to the treasurer by the holders. When this occurs in the instance where the moneys have been remitted in advance, the treasurer has, in effect, paid the bonds and coupons twice, until such time that the treasurer seeks a refund of the moneys previously advanced to the fiscal agent.

Other things being equal, we believe the state should seriously consider the competitive aspects of the services and charges of fiscal agents as well as the deferment of the disbursement of state moneys until necessary. In our opinion, it is more advantageous for the state to deal with a fiscal agent who does not require advance payment of state funds and who offers the best services at the lowest rate. We believe that matters such as these should be the subject of negotiation between the state and fiscal agents.

RECOMMENDATION

We recommend that the treasurer, state controller, and Board of Examiners cooperate to evaluate the services and charges presently rendered by fiscal agents and in the future base the selection of fiscal agents upon the services which are most advantageous to the state.

Uniform Bond Indenture

Heretofore bond issues have been approached and handled individually

without any uniformity insofar as the underlying and authorizing documents are concerned. The university units issue some under "open end" indentures, while other issues are made under separate indentures. The Board of Examiners also issue bonds under separate indentures as does the Water Resources Board. No attempt has been made to explore, evaluate, design or establish a pro forma bond indenture having uniform or common provisions which could be amended on an exception basis.

Presently, bond indentures are designed by the bond counsels engaged by the state for each issue, and the only common aspect among the indentures is that the same bond counsel may be used from time to time. As a result, some of the past bond issues and underlying indentures have contained provisions which have adversely affected the treasurer's paying responsibility and the controller's recording responsibilities. For example, bond issues at Eastern Montana College, Northern Montana College, and the Water Resources Board excluded the treasurer as paying agent and as a result, the sale and retirement of these issues has occurred completely outside of the state treasury and accounting processes. Similarly, the recent issue of bonds at Montana State University would have excluded any registration of bonds by the treasurer, had not the underlying resolution been amended. This would have resulted in bonds being registered at the university level without the treasurer having knowledge of the registration.

We believe that one or more basic formats or pro forma bond indentures would facilitate general understanding and review of prospective bond issues and would provide a uniform basis for insuring that the state is adequately protected. It would also, in our opinion, assure that the basic objective of centralized control and debt management is achieved, and that situations such

as those at Northern Montana College and Eastern Montana College do not occur again.

RECOMMENDATION

We recommend that the treasurer, state controller, and Board of Examiners explore the possibility of using uniform bond indentures for all future bond issues.

Use of Registered-Type Bonds

In the past, the majority of bonds issued by the state and its instrumentalities have been coupon-type bonds rather than registered or non-coupon type bonds. The use of coupon-type bonds causes a number of problems such as (1) additional record keeping duties; (2) excessive clerical time in receiving, sorting, and processing coupons; and (3) extensive safeguard precautions for paid coupons. On the other hand, registered-type bonds alleviate the necessity for most of these procedures thereby facilitating eventual application of data processing techniques. Registered-type bonds also permit the periodic setting aside of funds for interest payments and simplify interest calculations as well as interest payments. While we recognize that the decision to use one type of bond rather than the other is often based on potential market considerations, we believe the advantages of one type over the other warrants serious consideration in the planning of prospective issues.

Aside from market considerations, we believe the use of registered-type bonds would simplify the recording of bonded-debt; the scheduling, calculation and payment of interest; and provide a gradual basis for eventual conversion to data processing methods.

RECOMMENDATION

We recommend that the treasurer, state controller, and Board of Examiners cooperate in exploring the relative advantages and disadvantages of registered-type bonds as opposed to coupon-type bonds and that they make a conscious effort to use registered-type bonds in the future.

Alpha-Numeric Identification of Bonds and Coupons

In the past, bonds and coupons issued by the state and its agencies carried numerals to identify the individual bond and coupon, however, no separate alpha-numeric identification was inscribed to indicate which bond issue it was. The only means available to associate bonds and coupons with an individual issue was the color, which varied from issue to issue, and the fine print on the face of the bonds and coupons, which names the issue. For example, the long range building program bond issue, Series 1, consisted of bonds which were serially numbered from 1 to 1728. Each of these 1728 bonds had coupons attached, which show the bond number and the coupon number. In this instance, the bonds and coupons are dark orange in color. In contrast, long range building program bonds, Series 2, consisted of dark blue bonds ranging in number from 1 to 2210 with coupons attached in the same manner as the first example.

As illustrated by the above examples, the bonds and coupons are identifiable only by their respective colors and the fine print on each. There are no identifying numbers or letters which set either of these issues aside from the other 50 or so state bond issues.

In paying and otherwise processing these bonds and especially the coupons, the treasurer has to first sort the items by color and then sort the shades of

color. Upon achieving this, the treasurer sorts the items of each color into consecutive and chronological order for payment, all of which is done manually.

As stated previously, we believe that the area of bonded indebtedness is particularly susceptible to the application of data processing techniques. The effective use of such techniques is almost prohibited, however, by the fact that bond issues are not readily identifiable by numbers or letters rather than colors, which are beyond the capability of data processing equipment. As a result, we believe the state should begin taking measures whenever possible to initiate alpha or numeric identification of bond issues to permit and facilitate eventual conversion to data processing.

Acting on our suggestions in April 1970, the state controller took appropriate action to devise and implement a system in which bond issues were identified by a series of numerals. The controller began using this system with the most recent bond issue at Montana State University.

RECOMMENDATION

We recommend that the state controller continue assigning numeric symbols to future bond issues and strive to eventually perform the processing of paid bonds and coupons by automatic data processing means.

APPROPRIATION EXPENDITURES

Time and Attendance Reporting

No formal daily time records are maintained by treasury employees. The deputy treasurer keeps a record sheet which is given to the employees each month and upon which they retroactively mark down any sick or vacation leave taken. No cumulative records are maintained as to time off earned and/or taken.

RECOMMENDATION

We recommend that:

- 1. Attendance records be maintained by each employee on a current basis and approved by the appropriate supervisor.*
- 2. Cumulative control records showing accumulated vacation, sick leave, and overtime be established and maintained.*
- 3. A payroll clerk be designated to reconcile and provide control over these records.*

Sick Leave Regulations

The treasurer does not have any regulations governing the earning of sick leave, the use of sick leave, or the amount of sick leave time which can be accumulated. A formal policy should be established to provide both the employees and management with a definite basis for handling time off due to sick leave.

RECOMMENDATION

We recommend that the treasurer consult with the state controller in formulating a formal policy governing the earning, use, and accumulation of sick leave.

Payment for Unused Vacation Time

In the past, it has been the practice of the treasurer to pay employees for unused vacation time at the end of the state treasurer's four-year term. For example, at the end of December 1968, all employees of the treasury, except the deputy treasurer, were paid for their unused vacation time just as if the employees were permanently terminating their state employment. This practice apparently arose from the expectation that the new and incoming treasurer would replace the entire staff. Subsequent to 1968, however, only one employee was replaced by the new treasurer.

Normal state policy is to pay employees for vacation time as it is taken, and if they have any unused vacation time when employment is terminated, they are paid for it at that time. We believe the same practice should be instituted in the Treasurer's Office.

RECOMMENDATION

We recommend that the treasurer discontinue the present practice and institute a policy whereby employees are paid for unused vacation leave only as it is taken or upon termination.

Allocation of Time and Expense

At the end of December 1968, the unused vacation and overtime payment of \$723 was charged to the abandoned property division appropriation even though this expense was not associated with abandoned property division activities. We were advised that this was done because the treasurer has no way of determining exactly how much time should be charged to one appropriation or the other, and because of this, the charge of \$723 was believed to be appropriate.

We believe the treasurer should have a definitive means of allocating the time of employees to its various appropriations, and that such a matter should not be relegated to retroactive estimates. Consistently during the course of our examination, we observed that the abandoned property clerk spent much more time assisting the other treasurer personnel in their duties, than they did in his. As a result, we question the propriety of allocating personal service expenses to the abandoned property appropriation when in fact, the abandoned property division is not benefiting from those services. We also noted that although the abandoned property division periodically performs a great deal of mailing, no postage expenses are allocated to the abandoned property appropriation, again because of the absence of a means of correlating cost and benefits.

We believe the treasurer should design a means by which the expenses associated with each of the two treasurer appropriations are correlated with the programs funded by each appropriation so that an accurate cost distribution can be made. A system such as this will facilitate future study of each of the functions as well as provide a realistic basis for cost based budgeting.

RECOMMENDATION

We recommend that the treasurer devise a means of allocating the cost of its activities to each of its appropriations on a factual and realistic basis.

Travel Claims

In the past, one of the duties of the abandoned property clerk was to act as courier between the treasurer and the local banks. As reimbursement for personal expenses incurred in performing this duty, the clerk was paid \$1.00

per working day. Since May 1969, however, most of the courier duties have been performed by the state treasurer and not the abandoned property clerk. Nevertheless, the treasurer has continued to prepare a claim in the abandoned property clerk's name and cash the resultant warrant. Because of the uncertainty as to who should get the money, the treasurer has retained the money for the last eight months in the treasurer's vault.

On April 16, 1970, the state treasurer requested authority from the Board of Examiners to continue the \$1.00 per day payment. The Board of Examiners granted this authority on April 20, 1970. Since we believe that the cost of maintaining records documenting the actual expense involved would probably exceed \$1.00 per day, we have no question about the reasonableness of the amount. We do believe, however, that all claims should be properly prepared in the name of whomever is incurring the expense.

RECOMMENDATION

We recommend that the treasurer prepare all travel claims in the name of the employee to be reimbursed.

Mailing of Warrants

All warrants drawn on the basis of claims prepared by the treasurer are returned to the treasurer from the State Auditor's Office for mailing.

In our attempts to establish better internal control standards throughout various state agencies, we have consistently recommended that the mailing of state warrants be accomplished by the State Auditor's Office and this has been accomplished for the most part. We believe the same system should be used by the treasurer, i.e., direct mailing of warrants.

RECOMMENDATION

We recommend that the treasurer confer with the state auditor to initiate a procedure in which all warrants drawn for the treasurer are mailed by the auditor.

Unexpended Appropriations

At June 30, 1969, \$5,095 from the escheated estates earmarked revenue account should have reverted to the escheated estates agency account and \$466 should have reverted from the unclaimed property earmarked revenue account to the unclaimed property agency account.

We called this matter to the attention of the accounting division of the State Controller's Office and the accounting division issued journal vouchers reverting the funds as described above.

We believe the State Controller's Office should make a specific effort to examine appropriation balances at year's end to preclude situations such as those presented above. The failure of balances to properly revert allows the possibility of agencies overexpending their appropriation under the erroneous impression that funds are available.

RECOMMENDATION

We recommend that the state controller take appropriate action to assure that appropriation balances subject to reversion, revert in a timely fashion.

CONCLUSION

All of the recommendations in this report have been discussed with the state treasurer and principal officials of other agencies encompassed by our recommendations

We have been informed by the state treasurer that since the completion of our examination several of our recommendations have been implemented.

We thank the state treasurer and his staff for their cooperation and assistance.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Morris L. Brusett". The signature is written in a cursive style with some flourishes.

Morris L. Brusett
Legislative Auditor

June 24, 1970

OFFICE OF THE STATE TREASURER
ALL FUNDS
COMBINED BALANCE SHEET
December 31, 1969

ASSETS

Cash:

On Hand	\$ 47,800	
Demand Deposits in Banks	30,425,770	
On Deposit with Fiscal Agents	61,444	
In Custody of U. S. Treasury (Note 1)	<u>25,610,080</u>	\$ 56,145,094

Investments of Surplus Cash:

General Fund Warrants (Note 2)	2,007,537	
Certificates of Deposit	9,301,250	
U. S. Treasury Bills and Bonds (at cost)	<u>9,854,035</u>	21,162,822

Due from Political Subdivisions of the State (Note 3)	5,509
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Due from Fiscal Agents (Note 4)	<u>16,225</u>
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Total Cash Accountability (Note 5)	\$ 77,329,650
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Fund Investments Held by State Treasurer
as Custodian

156,254,077

Total Assets	<u>\$233,583,727</u>
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FUND ACCOUNTABILITY

	<u>Cash</u>	<u>Investments</u>	<u>Total</u>
General Fund	\$ 3,099,428	\$ -	\$ 3,099,428
Earmarked Revenue Fund	23,702,938	1,377,400	25,080,338
Sinking Fund	2,252,981	2,000,934	4,253,915
Federal and Private Revenue Fund	6,233,165	39,000	6,272,165
Federal and Private Grant Clearance Fund	5,743,776	6,905,000	12,648,776
Bond Proceeds and Insurance Clearance Fund	860,242	500,000	1,360,242
Revolving Fund	5,920,320	50,000	5,970,320
Trust and Legacy Fund	164,215	58,135,080	58,299,295
Agency Fund (Note 6)	<u>29,352,585</u>	<u>87,246,663</u>	<u>116,599,248</u>
Total Fund Accountability	<u>\$77,329,650</u>	<u>\$156,254,077</u>	<u>\$233,583,727</u>

OFFICE OF THE STATE TREASURER
ALL FUNDS
STATEMENT OF CHANGES IN FUND ACCOUNTABILITY
Calendar Year Ended December 31, 1969

<u>Fund</u>	<u>Fund</u> <u>Accountability</u> <u>January 1, 1969</u>	<u>Receipts</u> <u>And</u> <u>Transfers In</u>	<u>Disbursements</u> <u>And</u> <u>Transfers Out</u>	<u>Fund</u> <u>Accountability</u> <u>December 31, 1969</u>
General Fund	\$ 4,031,939	\$ 70,263,472	\$ 71,195,983	\$ 3,099,428
Earmarked Revenue Fund	20,871,100	77,425,166	73,215,928	25,080,338
Sinking Fund	6,839,304	12,796,580	15,381,969	4,253,915
Federal and Private Revenue Fund	6,904,014	85,742,777	86,374,626	6,272,165
Federal and Private Grant Clearance Fund	14,207,798	94,050,900	95,609,922	12,648,776
Bond Proceeds and Clearance Fund	7,310,321	9,395,006	15,345,085	1,360,242
Revolving Fund	2,602,772	99,500,381	96,132,833	5,970,320
Trust and Legacy Fund	55,451,045	6,337,600	3,489,350	58,299,295
Agency Fund	<u>99,031,244</u>	<u>253,947,493</u>	<u>236,379,489</u>	<u>116,599,248</u>
Total	<u>\$217,249,537</u>	<u>\$709,459,375</u>	<u>\$693,125,185</u>	<u>\$233,583,727</u>

OFFICE OF THE STATE TREASURER
GENERAL FUND AND EARMARKED REVENUE FUND
STATEMENT OF EXPENDITURES AND ENCUMBRANCES COMPARED WITH APPROPRIATIONS
Calendar Year Ended December 31, 1969

	General Fund		Earmarked Revenue Fund		
	Personal Services	Operation and Capital	Unclaimed Property Account	Oil and Gas Cons. Comm. Acct.	Total
Appropriation Balance, January 1, 1969	\$ 24,891	\$ 10,152	\$ 3,703	\$ -	\$ 3,703
Appropriation Reversions, June 30, 1969	(678)	(2,888)	(466)	-	(466)
1969-70 Appropriation	56,660	6,325	8,734	25,000	33,734
Total Available	80,873	13,589	11,971	25,000	36,971
Expenditures	49,244	9,391	6,347	-	6,347
Transfer to General Fund	-	-	-	25,000	25,000
Encumbrances	-	1,297	34	-	34
Unencumbered Balance, December 31, 1969	\$ 31,629	\$ 2,901	\$ 5,590	\$ -	\$ 5,590

OFFICE OF THE STATE TREASURER

NOTES TO FINANCIAL STATEMENTS

1. Cash in Custody of U. S. Treasury represents funds contributed by employers in the state for unemployment insurance under the Federal Social Security Act and Title 87, R.C.M. 1947. The cash is not a cash resource of the state, is specifically restricted by federal law, and does not revert to the state treasury.
2. Investments of Surplus Cash in General Fund Warrants represents state warrants drawn on the General Fund in the normal course of business, paid by the Office of the State Treasurer using surplus treasury cash, and held in the treasury vault until sufficient General Fund moneys become available for their payment. These warrants are not registered and draw no interest.
3. Due from Political Subdivisions of the State consists of moneys due the state as a result of state redemption of matured bonds and coupons issued by various counties, school districts, and cities within the state.
4. Due from Fiscal Agents consists of moneys due the state as a result of matured state bonds and coupons redeemed by the Office of the State Treasurer and for which reimbursement is due from various funds and fiscal agents.
5. Cash balances are reduced by warrants paid by the Office of the State Treasurer as opposed to those drawn and issued upon each fund. Issued but unpaid warrants as of December 31, 1969, totaled \$31,373,000 which includes redeemed but unpaid General Fund warrants totaling \$2,008,000.
6. Agency Fund balances include amounts in four accounts which are recorded and accounted for by the state treasurer, but are not reflected in the state

NOTES TO FINANCIAL STATEMENTS (Continued)

controller's central accounting records, as follows:

Secretary of State Suspense Account	\$ 14,538
Highway Patrol Safety Responsibility Deposits	36,413
Liquor Control Board Revolving Account	94,593
Water Conservation Debt Service	<u>3,034</u>
Total, December 31, 1969	<u>\$148,578</u>

